Scottish Law Commission

promoting law reform

(DISCUSSION PAPER No.175)

Discussion Paper on Heritable Securities: Non-monetary securities and sub-securities

discussion paper

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June 2023

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The Commission would be grateful if comments on this Discussion Paper were submitted by 29 September 2023.

Please ensure that, prior to submitting your comments, you read notes 1-2 on the facing page. Respondents who wish to address only some of the questions and proposals in the Discussion Paper may do so. All non-electronic correspondence should be addressed to:

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[1] Kate Dowdalls KC was also a Commissioner at the time that this Discussion Paper was peer reviewed.

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Abbreviations

1970 Act

Conveyancing and Feudal Reform (Scotland) Act 1970

2003 Act

Title Conditions (Scotland) Act 2003

2007 Act

Bankruptcy and Diligence etc. (Scotland) Act 2007

2012 Act

Land Registration etc. (Scotland) Act 2012

BDS

Bond and disposition in security

Burns*, Conveyancing Practice*

J Burns, F MacRitchie (ed.), *Conveyancing Practice According to the Law of Scotland* (4th edn, 1957)

Cusine and Rennie, *Standard Securities*

D J Cusine and R Rennie, *Standard Securities* (2nd edn, 2002)

DP1

Scottish Law Commission, Discussion Paper on Heritable Securities: Pre-default (DP No 168, 2019)

DP2

Scottish Law Commission, Discussion Paper on Heritable Securities: Default and Post-Default (DP No 173, 2021)

Gloag and Irvine, *Rights in Security*

W M Gloag and J M Irvine, *Law of Rights in Security, Heritable and Moveable, including Cautionary Obligations* (1897)

Gretton, *Inhibition and Adjudication*

G L Gretton, *Inhibition and Adjudication* (2nd edn, 1996)

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W M Gordon and S Wortley, *Scottish Land Law* (3rd edn, 2020)

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Scottish Home and Health Department, Conveyancing Legislation and Practice (Cmnd 3118, 1966)

Halliday, *The Conveyancing and Feudal Reform (Scotland) Act 1970*

J M Halliday, *The Conveyancing and Feudal Reform (Scotland) Act 1970* (2nd edn, 1977)

Higgins, *Enforcement*

M Higgins, *The Enforcement of Heritable Securities* (2nd edn, 2016)

MacPherson, *Floating Charge*

A D J MacPherson, *The Floating Charge* (2020)

Notes on Clauses

Conveyancing and Feudal Reform (Scotland) Bill 1970, House of Commons, Notes on Clauses (held in the Scottish Government Law Library and not fully paginated). These are equivalent to today's Explanatory Notes.

NRS

National Records of Scotland

PRB

Personal real burden

Reid, *Property*

K G C Reid, *The Law of Property in Scotland* (1996)

Reid and Gretton, *Land Registration*

K G C Reid and G L Gretton, *Land Registration* (2016)

Report on Moveable Transactions

Scottish Law Commission, Report on Moveable Transactions (Scot Law Com No 249, 2017) (3 vols)

SPV

Special Purpose Vehicle

Glossary

Accessoriness principle: The principle that a security right has no independent existence, but is merely accessory to, or parasitical upon, another right, namely the obligation whose performance it secures. An Arizona court put it thus: “The note [personal obligation] is the cow and the mortgage the tail. The cow can survive without the tail, but the tail cannot survive without the cow.” (*Best Fertilizers of Arizona Inc v Burns*, 117 Ariz 178, 571 P 2d 675 (App 1977)). The secured obligation does not have to be an obligation owed by the grantor of the security: one person can grant a security for another’s debt.

Ad hunc effectum: A *deed* granted by a *person* subject to an *inhibition* may be reduced *ad hunc effectum* by the inhibiting creditor. This is a relative form of *reduction*, meaning the transaction is reduced only insofar as necessary for the obligation owed to the inhibiting creditor to be fulfilled.The literal translation of ”ad hunc effectum” is “to this effect”, but it is more generally used to mean “with limited effect”. See para 5.19 for further discussion.

Adjudication: A form of *diligence* which can be used by a creditor against the *heritable property* of the debtor, allowing the creditor to take security in the property and sell it under specific circumstances.

Advance notice: The advance notice system was introduced by Part 4 of the Land Registration etc. (Scotland) Act 2012. An advance notice operates by protecting the priority of a *deed* registered in the *Land Register* (or recorded in the *Register of Sasines*) during a specific period against competing deeds registered (or recorded) earlier in the same period.

All sums security: A *standard security* granted over all sums due or which may become due by the debtor to the creditor. These securities cover any advances made by the creditor at the time at which the security is granted and all future advances until the security is discharged.

Assignation: The *deed* used to transfer a *standard security.* More broadly, the transfer of *incorporeal property*.

Assignation in security: The transfer of *incorporeal property* from debtor (*cedent*) to creditor (assignee) in security for a debt. The debtor has a right to reconveyance of the property (*retrocession*) once the debt has been satisfied.

Bond and disposition in security: Older form of *heritable security* in which the debtor retained ownership of the property and the creditor obtained a subordinate real right. The debt had to be a fixed amount which was contracted for prior to the grant of the security. Not competent since 1970.

Bond of cash credit and disposition in security: Similar form of *heritable security* to the *bond and disposition in security* but which allowed credit given by a bank in relation to an account to be secured up to a maximum figure. Not competent since 1970.

Cedent: The party in an *assignation* who transfers *incorporeal property* to the assignee. The term assignor may also be used. These terms are synonymous with “transferor” in the context of an assignation.

Conditional Advance Notice: As discussed in Chapter 4, this is the name we have have used for a notice which forms part of our proposed scheme for protecting obligations to transfer land. We seek views on this name in paragraph 4.34, question 6.

Deed: A formal, written document which has different legal effects depending on the type of deed. A disposition, for example, is a deed which is used to transfer property ownership.

Discharge: The *deed* used to extinguish a *standard security*.

Diligence: The broad term for processes used to enforce the recovery of debts, such as *adjudication*, arrestment and *inhibition*.

Dominium utile: In the feudal system of landholding, the *dominium utile* was the form of ownership held by the *person* at the bottom of the feudal chain (the vassal). This allowed the vassal to make day-to-day use of the land but was subordinate to the higher right of the feudal superior. The feudal system has been abolished in Scotland.

Equity/equitable: In English law, some rights have a double existence: they may exist "at law" or "in equity". (In the ordinary sense of the word "law" they are both part of English law.) Rights in security can be either legal or equitable. In general, equitable securities are created by simple agreement, without any external act. An equitable security is generally valid in the debtor's insolvency. But it is often defeasible (ie capable of being defeated or overridden by the right of a third party), for example if the debtor sells the property to a purchaser who is in good faith then the purchaser takes the property free of the security. Thus it is often weaker than a legal security. The legal/equitable distinction does not exist in Scots law. "Equity" also means the market value of an asset, less the amount of debt secured over it. Thus if land is worth £1,000,000 and there is over it a standard security, securing a debt of £400,000, the "equity" of the property is £600,000.

***Ex facie* absolute disposition**: Older form of *heritable security* in which the property was transferred to the creditor but with the right to a reconveyance on the secured debt being paid. Not competent since 1970.

***Ex facie* absolute assignation**: A form of *assignation in security* in which it may not be clear on the face of the assignation document that the transfer is for the purposes of security.

Heritable property: Immoveable property, i.e. land and rights in land. Strictly, the term "heritable property" also applies to other very limited types of property such as pensions.

Heritable security: The general term for security over *heritable property*. There is a broad statutory definition of "heritable security" in section 3 of the Titles to Land Consolidation (Scotland) Act 1868. That definition, however, excludes the *ex facie absolute disposition* which in functional terms can be regarded as a heritable security. The term "heritable security" would not normally be used to refer to a floating charge. While that form of security does affect land, it is typically granted by a company over all its assets.

Incorporeal property: Property without a physical presence, such as a lease, patent, or claim to repayment under a loan contract.

Inhibition: A form of *diligence* typically used to enforce payment of a debt. An inhibition affects all *heritable property* in Scotland within the patrimony of the *person* against whom it is registered. However, it may also be used to enforce an obligation to convey or grant a

subordinate real right in a particular piece of heritage, in which case the inhibition is limited to the property to which the obligation relates. Where an inhibited person voluntarily grants a disposition or subordinate real right in property caught by the inhibition to a person other than the inhibiting creditor, this breaches the inhibition. The creditor may seek *reduction* of the transaction *ad hunc effectum*. In practice, a third party will invariably refuse to deal with property subject to an inhibition without the inhibiting creditor's consent.

Judicial security: A form of involuntary security created by grant of the court. Also known as a *diligence*.

Juridical act: Any act of will or intention which has, or which is intended by the maker of the act to have, legal effect, but not including any legislative or judicial act.

Juristic person: An entity or body recognised in law as having independent legal personality akin to natural *persons*. E.g. a company.

Keeper of the Registers of Scotland: Commonly referred to as "the Keeper". The official who heads the Department of the Registers of Scotland and in whose name all acts and decisions are made.

Land Register: The register of title to land in Scotland. A *standard security* must be registered in this register to give a creditor a real right. (The Land Register is gradually replacing the *Register of Sasines*, a register of *deeds*.)

Mortgage: A term in the law of England and Wales for the main form of security over land, which has come into general usage including in Scotland. When used informally in the Scottish context, the term generally refers to a *standard security*.

Moveable property: All property which is not *heritable property*. Moveable property may be corporeal property or *incorporeal property*.

Non-opposability principle: The principle by which an *advance notice* accords priority to a protected *deed*. Where a deed protected by an advance notice is registered later than a competing deed, the protected deed takes effect as though the competing deed had never been registered. The effect of the competing deed is also adjusted to reflect the priority of the protected deed, but the competing deed is otherwise unimpaired. This is also known as the principle of "relative invalidity."

Obligation *ad factum praestandum*: An obligation to do something, such as to convey land.

Offside goals rule: A general doctrine of property law. If X contracts to transfer a right (eg ownership of land) to Y, but in fact transfers it to Z, and Z knew that X was acting in breach of the X/Y contract, then Z has "scored" an "offside goal". The result is that Y can have the X/Z transfer set aside. Thus Y's personal right prevails over Z's real right. The doctrine can apply not only to transfers but also to certain other types of transaction, but its exact parameters, including in relation to security rights, are unclear.

Option agreement: An agreement between a land owner and a prospective buyer/lessee in which the buyer/lessee has the option, within a specific "option period" and possibly subject to

certain conditions, to buy or take a lease of the property. A typical example of an option agreement is between a land owner and a developer seeking to use the land for residential or commercial development. The developer may exercise their option to buy land from the land owner if the condition of obtaining planning permission for development is satisfied within the option period.

Person: In law a person is the subject of rights and obligations. So as well as (i) natural persons (in other words, human beings) there are (ii) *juristic persons* (also called legal persons) such as companies.

Personal right: A right against a *person*. Also called a "claim". Contracts create personal rights, but such rights can also have other sources. A personal right is as good as the person against whom it is held. A personal right against the Bank of England to be paid £1 is better than a personal right for the same amount against a person who has become insolvent. A right may still be personal even if it relates to property. For example if X owns land and contracts to transfer it to Y then Y has a personal right against X. A *real right* is a right directly in a thing rather than against a person. Thus when Y's name replaces X's in the *Land Register*, Y has a real right in the land, and the personal right against X to have the land transferred is now spent. Real rights are as good as the thing in which they are held.

Primary and secondary claims/debts/securities: In the context of Chapters 6 and 7 of this Discussion Paper, these terms are used to describe the relationship between certain claims to repayment, debts, and securities in *sub-security* arrangements and *assignations*. Take the following example: (1) Anna borrows money from Bob; (2) Bob borrows money from Caledonian Bank; (3) Bob assigns in security to Caledonian Bank the claim to repayment against Anna as security for debts owed by Bob to Caledonian Bank. It is useful to have terms to describe the relationship between transactions (1) and (2) following step (3) (the *assignation in security*). The claim to repayment of debt held by Bob (the "primary creditor") against Anna (the "primary debtor") is described as the "primary claim." The claim to repayment held by Caledonian Bank (the "secondary creditor") against Bob (the "secondary debtor") is the "secondary claim." Thus, in step (3), Bob assigns in security the primary claim to Caledonian Bank as security for the secondary debt.

Proprietor: Term used by the 1970 Act for the owner of property.

Publicity principle: The principle that what affects third parties should be discoverable by third parties. It is not an absolute principle. Different legal systems apply the principle with varying degrees of enthusiasm.

Real burden: An obligation affecting land. These can be positive, such as an obligation to maintain the land, or negative, such as the obligation not to conduct trade on it. Real burdens are said to "run with the land", meaning that the land continues to be affected by the obligation when ownership of the land changes.

Real right: See also *personal right*. Real rights divide into (i) ownership and (ii) the subordinate real rights (or "limited") real rights, which are rights held in something that is owned by someone else. For example if X owns land and borrows money from Y, granting to Y a standard security, there are now two real rights in the property, X's real right of ownership and Y's subordinate real right of security. A subordinate real right is also called a *jus in re aliena*.

Redemption: The right of the grantor of the security to have it extinguished on the secured debt being paid.

Reduction: The annulment or 'setting aside' of a *deed*, contract or decree.

Register of Sasines: The older register of land in Scotland, with the full name the General Register of Sasines. Established by the Registration Act 1617. Has been gradually replaced by the *Land Register* since 2012, and is due to close by 2024.

Register of Inhibitions: A public register recording which individuals are subject to *inhibitions.* Formerly known as the Register of Inhibitions and Adjudications.

Restriction: In Scots law, the *deed* used to restrict a *standard security* to only part of the property over which it was initially granted. In English law, a restriction regulates the circumstances in which a disposition can be registered in relation to a particular estate. This can be used to prevent the registration of any deed in relation to a plot of land that does not comply with the terms of an *option agreement*.

Retrocession: Where the debt owed by an assignee to the *cedent* under an *assignation in security* is repaid, retrocession is the consequent *assignation* of the property back to the cedent.

Security property: The property which is subject to a security. The Conveyancing and Feudal Reform (Scotland) Act 1970 uses the term “security subjects”.

Sequestration: The principal procedure in Scots law for resolving the insolvency of natural *persons* and some non-incorporated bodies. The process is more commonly referred to as bankruptcy.

Singular successor: a *person* who acquires title to land from the previous owner by gift or for consideration. In most cases this will be a purchaser. A singular successor can be contrasted with a universal successor who acquires title by succession following the death of the previous owner.

Standard conditions: A set of statutory conditions found in Schedule 3 to the Conveyancing and Feudal Reform (Scotland) Act 1970 which are incorporated into every *standard security*. Most are variable by the parties to the security but some, in particular in relation to enforcement, are not.

Standard security: The only type of *heritable security* which can be granted under the current law. It gives the grantee a limited right in the property, leaving ownership with the grantor. A standard security is created by registration in the *Land Register*. The governing legislation is the Conveyancing and Feudal Reform (Scotland) Act 1970.

Sub-security: Generally an arrangement where a right in security is held in an existing secured claim. In the context of this paper, this often refers to the situation where a standard security is taken over an existing standard security. Further explanation of sub-securities can be found at paragraphs 6.3 to 6.8 and 6.21 to 6.27.

Sui generis: Latin term meaning ‘of its own kind.’

Special Purpose Vehicle: a *juristic person* (generally a limited company) created for a particular purpose.

Title condition: A condition in the title to a property which affects its use, such as a *real burden* or servitude.

True security: A security right that is a subordinate *real right*, leaving title to the property in the provider of the security. Also known as a “proper security”. A *standard security* is a true security.

Variation: The *deed* used to amend a *standard security* other than to reduce the extent of the encumbered property, where a *restriction* must be used.

Vormerkung: A priority notice under German land registration law, which can protect future and conditional land obligations.

Chapter 1 Introduction

Introduction

1.1 This is the third Discussion Paper in our project on Heritable Securities. It covers two complex issues arising in this area of the law, namely security in respect of non-monetary obligations,[1] and sub-security arrangements.

1.2 In the context of heritable securities in Scotland, the term "non-monetary obligation" generally refers to an obligation to do something other than pay a debt. One example might be an obligation on the recipient of a grant to carry out works funded by that grant. Another might be an obligation on a land owner to transfer land at a future date if particular conditions are met (an option agreement). The grant of a standard security in respect of obligations of this type is competent under the current law,[2] and occurs regularly in practice in connection with particular types of land transaction.[3] However, there is uncertainty as to how the remedies available under a standard security can be of use in enforcing the performance of such obligations. Other questions, notably in relation to how these types of securities rank against competing securities for debts, also arise.

1.3 A sub-security arrangement, in this context, describes the situation where a standard security is taken over an existing standard security. Unlike a more conventional standard security arrangement, where the security property will be the ownership of land or the tenant's interest in a lease, the security property in this arrangement is itself a standard security. The creation of such sub-securities is viewed as an important step in high-value securitisation and debt warehousing transactions in the commercial finance sector. We have also heard of these types of securities being used in complex land transactions. While the law appears to permit the creation of these "secondary" or "piggyback" standard securities, questions arise over the conceptual soundness and practical utility of this approach. How a secondary standard security can be exercised is a key source of uncertainty.

1.4 This Discussion Paper explores both these issues and seeks views on provisional proposals for reform to deal with the difficulties arising under the current law.

Project Structure

1.5 The law of heritable securities was first identified as a project in our Eighth Programme of Law Reform.[4] It was carried over into our Ninth Programme,[5] with work beginning under our

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[1] Often referred to as obligations *ad facta praestanda*.
[2] Conveyancing and Feudal Reform (Scotland) Act 1970 ss 9(3) and 9(8)(c).
[3] We consider common examples at para 2.27.
[4] Scottish Law Commission, Eighth Programme of Law Reform (Scot Law Com No 220, 2010) available at: https://www.scotlawcom.gov.uk/files/9412/7989/6877/rep220.pdf.
[5] Scottish Law Commission, Ninth Programme of Law Reform (Scot Law Com No 242, 2015) available at: http://www.scotlawcom.gov.uk/files/6414/2321/6887/Ninth_Programme_of_Law_Reform_Scot_Law_Com_No_242.pdf.

Tenth Programme[6] in 2018. The project is due to conclude during our Eleventh programme[7] with a final Report expected in 2025.

1.6 Our review of the law in this area is set out in this and the two preceding Discussion Papers for the project. Our first Discussion Paper,[8] published in June 2019, focused on pre-default issues, chiefly creation, assignation and extinction of heritable securities. We received 22 responses to this paper from a mixture of law firms and practitioners, academics and organisations including the Royal Bank of Scotland and UK Finance. As discussed below, responses to questions in the first Discussion Paper influenced our approach to the project, and in particular, prompted the decision to include this third Discussion Paper in the project.

1.7 Our second Discussion Paper[9] was published in December 2021, and dealt with default and post-default issues. The main work of that paper was a systematic review of the processes by which a secured obligation is enforced through the exercise of a standard security. We received 25 responses to that paper from a mixture of law firms and practitioners, academics, organisations and individuals.

1.8 As summarised above, this third and final Discussion Paper focuses on non-monetary securities and sub-securities. We outline the structure of the paper below. The findings from all three Discussion Papers will be drawn together into a single Report and draft Bill at the conclusion of the project.

Background to this Discussion Paper

1.9 When this project was first included in our reform programme, we set out five reasons as to why the work was required, including difficulties with the drafting of the key piece of legislation in this area, the Conveyancing and Feudal Reform (Scotland) Act 1970.[10] The primary objective of the project is to modernise and improve the law of standard securities as set out in the 1970 Act, producing a draft Bill which could be passed by the Scottish Parliament.[11] The focus of the project, as set out in DP1, is the law of rights in security rather than the law of credit.[12]

1.10 More generally, the approach taken in the project is one of "evolution, not revolution," recognising that although the current law can clearly be improved upon, it is not fundamentally broken.[13] While our provisional proposals in this paper perhaps suggest more significant change than those in the two preceding papers, we consider they will bring much needed clarity to the law in respect of the two complex issues considered. The fundamental,

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[6] Scottish Law Commission, Tenth Programme of Law Reform (Scot Law Com No 250, 2018) available at: https://www.scotlawcom.gov.uk/files/5615/1922/5058/Tenth_Programme_of_Law_Reform_Scot_Law_Com_No_250.PDF.
[7] Scottish Law Commission, Eleventh Programme of Law Reform (Scot Law Com No 264, 2023) available at: https://www.scotlawcom.gov.uk/files/1816/8552/2957/Eleventh_Programme_of_Law_Reform_2023_-_2027.pdf.
[8] DP1.
[9] DP2.
[10] Scottish Law Commission, Eighth Programme of Law Reform (Scot Law Com No 220, 2010) paras 2.29-2.33 available at: https://www.scotlawcom.gov.uk/files/9412/7989/6877/rep220.pdf. See also DP1, paras 1.8 to 1.12.
[11] DP1 para 1.13.
[12] DP1 paras 1.9 and 1.13.
[13] DP1 para 1.19.

conceptual underpinnings of the law of standard securities remain intact and, indeed, are strengthened by these proposals.

1.11 The need for this third Discussion Paper was identified following consideration of the consultation responses to DP1, and helpful discussions with stakeholders about the use of non-monetary securities and sub-securities in practice. We aired initial concerns about the use of standard securities to protect obligations to transfer land in DP1. We received significant support from consultees for further work exploring an improved mechanism by which this protection could be provided, and which did not necessarily rely on a standard security to do so. We present provisional proposals in that respect here. The responses to DP1 also made clear to us that the position in respect of sub-securities must be clarified when any new legislation on standard securities is introduced. For the reasons we discuss later, retaining the status quo on this issue is not, in our view, desirable or possible, and in this paper we suggest reforms to clarify the law in future.

Methodology

1.12 As noted in our first Discussion Paper, in working on this project we are helped considerably by the existing literature on heritable securities in Scotland.[14] Due to the specialist nature and relative novelty of the issues covered in this paper, coverage in the literature is less extensive than in relation to more mainstream topics in the law of heritable securities. In that respect, we have more than ever been indebted to the assistance received from our advisory group and other practitioners in this area.

1.13 With specific regard to the 1970 Act we have been assisted by looking at the Parliamentary Debates when this legislation was being enacted and the Notes on Clauses, held in the Scottish Government Law Library, the equivalent of today's explanatory notes. As discussed in Chapters 2 and 6, we have also found archive material held by National Records of Scotland pertaining to the drafting of the Bill which lead to the 1970 Act of great assistance.

1.14 As we have mentioned in the previous Discussion Papers, this project was viewed as an opportunity to consider comparative law in this area. Comparative research had not been undertaken in previous reviews.[15] We have built upon comparative work carried out earlier in the project in relation to the issues considered in this paper, with material from England and Wales and Germany proving particularly helpful in our consideration of non-monetary obligations.

Structure of this Discussion Paper

1.15 This Discussion Paper is composed of seven Chapters. Chapters 2 to 5 focus on issues relating to non-monetary securities and Chapters 6 and 7 discuss standard securities taken over standard securities.

1.16 More specifically, Chapter 2 explores the historical development of the law in relation to non-monetary securities, the background to the inclusion of the relevant provisions in the 1970 Act and considers examples of how such securities are used in practice today. No

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[14] E.g. Halliday, *The Conveyancing and Feudal Reform (Scotland) Act 1970*; Cusine and Rennie, *Standard Securities* and Higgins, *Enforcement.*

[15] Notably the Halliday Report.

consultation questions are asked in Chapter 2. However, it provides essential context for the reform proposals which follow, particularly by identifying the two categories into which the types of secured obligations found in practice generally fall: (a) those where financial remedies available under the security may suffice to satisfy the needs of the creditor; and (b) those where financial remedies will not suffice, typically obligations to transfer land.

1.17 Chapter 3 considers what (relatively modest) provision may be required in any new legislation to cater adequately for a standard security taken in respect of a non-monetary obligation where a financial remedy will meet the needs of the creditor. In Chapter 4, we consider the more challenging reform required to meet the needs of creditors in relation to future and conditional obligations to transfer land. We set out provisional proposals for a new mechanism for protecting such obligations against the grant of competing deeds. This mechanism is based on the advance notice scheme introduced by the Land Registration etc (Scotland) Act 2012[16] and provisionally referred to as a "conditional advance notice". In Chapter 5, we discuss possible alternative mechanisms for the protection of obligations to transfer land against competing deeds and explain why we consider the conditional advance notice scheme to be the preferable approach.

1.18 Chapter 6 recaps the development of the law in relation to heritable sub-securities and discusses the situations in which standard securities taken over standard securities are used in practice. Chapter 7 seeks views on provisional proposals for reform. First, we suggest that it should no longer be possible to grant a standard security over a standard security under any new legislation. Secondly, we consider how the law might be clarified in relation to assignation in security of a standard security in future.

Legislative Competence

1.19 As we noted in our previous Discussion Papers, our aim is to produce a draft Bill which is within the legislative competence of the Scottish Parliament. The law of heritable securities, as an aspect of Scots Private Law,[17] is not a reserved matter under Part II of the Schedule 5 to the Scotland Act 1998. In so far as there are areas relevant to the project reserved to the UK Parliament[18] we will work within these.

1.20 An Act of the Scottish Parliament is not law so far as any provision of the Act is outwith the legislative competence of the Parliament and a provision is outside that competence in so far as it is incompatible with any right under the European Convention on Human Rights.[19] In suggesting reforms we require to ensure that these would be ECHR-compliant. We do not consider that the matters which we address in this Discussion Paper raise particular ECHR issues.

Impact Assessment

1.21 When our Report is published it will be accompanied by a BRIA (Business and Regulatory Impact Assessment). We require therefore to assess the impact, particularly the

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[16] Land Registration etc (Scotland) Act 2012 ss 56-64.
[17] Scotland Act 1998 s 126(4).
[18] Such as the subject matter of the Consumer Credit Act 1974, albeit that the subject matter of that Act is somewhat remote from the types of transactions which we discuss in this paper.
[19] Scotland Act 1998 s 29(2)(d).

economic impact, of any reform proposal that we may eventually recommend in this Report. Information on the impact of the current law is helpful in making this assessment. For example, uncertainty in the meaning of statutory provisions may result in a perception of increased risk in taking forward particular investments in Scotland. Given this paper relates to specific types of transactions and market sectors, we make a similar request for assistance as appeared in our first and second Discussion Papers.

1. What information or data do consultees have on:

(a) the economic impact of the current legislation on heritable securities in relation to transactions involving non-monetary securities or secondary standard securities?

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

Acknowledgements

1.22 We are grateful to the members of our advisory group, whose names appear in the Appendix. We have also listed the names of others who have been of particular help to the work on this project and to whom we would also express our thanks.

Chapter 2 Development and current law

Introduction

2.1 The Conveyancing and Feudal Reform (Scotland) Act 1970 provides that a standard security may secure "any debt",[1] with debt defined to include "any obligation…*ad factum praestandum*."[2] In this Chapter, we recap the development of the law in relation to this type of security, the background to the inclusion of this provision within the 1970 Act and the questions it raises for current practice. We do not pose any discussion questions in this Chapter. However, the summary here provides essential context for the questions asked in Chapters 3 and 4.

2.2 The terminology in this area is tricky. An obligation *ad factum praestandum* is an obligation to perform a specific act. The 1970 Act defines "debt" to include this type of obligation. A lay person might reasonably expect these definitions to be the other way around, since an obligation to repay money owed (a "debt") is an obligation to perform one type of specific act. Lawyers, generally speaking, will understand an obligation *ad factum praestandum* to be a non-monetary obligation. This understanding is insufficiently precise for present purposes. Such obligations may be wholly non-monetary, such as an obligation to build a wall. However, they may have a monetary aspect, such as an obligation to share the costs of building a wall. They may also contain a substitutionary monetary obligation enforceable if the primary obligation is not fulfilled, such as an obligation to build a wall failing which to pay someone else to do so. Even if no express provision is made, failure to perform an obligation *ad factum praestandum* will usually give rise to an obligation to pay damages. These variations within the category of obligations *ad facta praestanda*, elided in the 1970 Act, may go some way to explaining the confused state of the law as we discuss further below.

2.3 In this Chapter, we use the term "debt" to refer to an obligation to pay money owed. We use the term "obligation *ad factum praestandum"* to refer to an obligation to perform a specific act other than payment of money owed. Where necessary, we will also distinguish between obligations *ad facta praestanda* with a monetary aspect and those with no monetary element, apart from the entitlement to claim damages for breach.

History

2.4 The purpose of a right in security is to ensure performance of an underlying obligation. Exercising the security allows the holder to raise money from the security property, usually by selling it, and then to apply the money in satisfaction of the secured obligation. Where the secured obligation is non-monetary, there is an obvious mismatch between the purpose of the right and the remedies it makes available. How did Scots law develop in such a way that this mismatch came about? While there is no clear answer to this question, we speculate that the

[1] 1970 Act, s 9(3).
[2] 1970 Act, s 9(8). We gave detailed consideration to the types of obligation a standard security can secure in DP1 ch 4.

emergence of title condition real burdens in the mid-nineteenth century may have played a role.

2.5 Historically, the focus of rights in security were debts. Discussion of the older forms of heritable security by the institutional writers proceeds on this basis,[3] and treatment of *ad factum praestandum* security in conveyancing texts prior to the 1970 Act is scant.[4] In DP1, we noted that there appeared to be only one reported case involving an *ad factum praestandum* security prior to 1970, namely *Edmonstone v Seton*.[5] In that case, the secured obligation was to purchase an identified amount of Government stock.[6] The security documentation expressly provided that enforcement could be made against the land to raise funds if necessary to fulfil the obligation to purchase. As Lord Kinnear noted in his judgment at first instance,[7] and as we highlighted in DP1,[8] this particular obligation *ad factum praestandum* was little different from an obligation to pay money.

2.6 Where an obligation *ad factum praestandum* is expressly enforceable as a financial claim as in *Edmonstone*, it is easy to understand why the law would accept security being taken in respect of it. A similar approach is found in several of the jurisdictions we canvassed in our comparative analysis of this issue in DP1.[9] However, Scots law does not seem to have limited its recognition of *ad factum praestandum* security in this way. It is here that the law of real burdens may have played a role.[10]

2.7 A real burden, as that term was originally understood, was a mechanism by which a right in security could be reserved by a transferor of land in respect of debts owed to them by the transferee.[11] The right was a "true" security, in the sense that it was a secondary right ancillary to a separate personal obligation. It could be exercised by way of the diligences of adjudication and poinding of the ground, and conferred on the security holder the right to sell the security property if expressly set out in the constitutive deed.[12] Writing in 1984, Professor Reid noted that this form of security had flourished in the eighteenth and nineteenth centuries but had fallen out of favour during the twentieth.[13] The grant of new real burdens of this type, now renamed "pecuniary real burdens", became incompetent following the entry into force of section 117 of the Title Conditions (Scotland) Act 2003.

2.8 During the nineteenth century, a second type of real burden – one more familiar in the modern legal landscape – came to be recognised. This type of real burden was a mechanism by which a transferor of land could reserve the right to compel or prevent certain uses of that land by the transferee.[14] The burden was "real" in the sense that it ran with the land rather than being personal to the original parties, so that it could equally be exercised by successors of the transferor against successors of the transferee.[15] An obligation to build a dwelling house

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[3] Erskine, *Institute* II.8.2; Bell, *Principles* para 896; Stair, *Institutions* II.10.1.
[4] Burns, *Conveyancing Practice* 451 contains a short paragraph.
[5] *Edmonstone v Seton* (1888) 16 R 1.
[6] DP1 paras 4.16-4.18.
[7] (1888) 16 R 1 at 3.
[8] DP1 para 4.19.
[9] For example, DP1 paras 4.54 (Hungary), 4.55 (Louisiana), 4.57 (India) and 4.61 (South Africa).
[10] For fuller discussion, see K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9.
[11] For general discussion see Gloag and Irvine, *Rights in Security* 166-176; Burns, *Conveyancing Practice* 498-504.
[12] Gloag and Irvine, *Rights in Security* 173.
[13] K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 9.
[14] For general discussion see Reid, *Property* ch 8.
[15] K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 10. See also Reid, *Property* para 385.

or a prohibition on building over a certain height are examples of this type of burden. The obligation embodied by the burden had to relate to the land in question (in other words, it had to be praedial).[16] The burden was enforced by way of personal action.[17] This form of real burden, one of a broader category of title conditions including servitudes, continues in everyday use, with the modern law set out in the Title Conditions (Scotland) Act 2003.

2.9 The explanation above makes plain that the two types of burden were quite distinct in form and effect, notwithstanding the fact that both were created by reservation during the transfer of land.[18] However, this distinction does not appear to have been well understood at the time of the emergence of title condition burdens. Professor Reid traces the history, noting that the validity of title condition burdens continued to be disputed throughout the latter half of the nineteenth century.[19] The 1840 decision in *Tailors of Aberdeen v Coutts*,[20] now generally understood to be the foundation of the modern law of title condition burdens, itself displays confusion between the two types of real burden. Professor Reid argues convincingly that the well-known "purple passage" of Lord Corehouse's opinion,[21] "adopted almost universally by writers on conveyancing as a statement of the requirements for [title condition] burdens",[22] is in fact describing the requirements for pecuniary real burdens.[23]

2.10 The core of a title condition burden is generally an obligation *ad factum praestandum*, in current legislation defined as "an obligation to do something (including an obligation to defray, or contribute towards, some cost); or an obligation to refrain from doing something."[24] It is perhaps the case that, in establishing the broad nature of obligations appropriate for title condition burdens, the law lost sight of the more restricted forms of obligation appropriate for pecuniary real burdens. The treatment of *Edmonstone* by Gloag and Irvine is of interest here. The case is cited first as authority for the proposition that an obligation *ad factum praestandum* may be capable of fulfilling the requirement that a pecuniary real burden must be for a definite amount.[25] Later it is cited as authority for the proposition that an obligation *ad factum praestandum* which resolves itself into the payment of a sum of money may nevertheless be constituted as a title condition burden.[26] Once it was accepted that title condition burdens could be monetary or non-monetary, it was perhaps forgotten that pecuniary real burdens could not.

2.11 It is difficult to draw conclusions with any certainty. What is clear, however, is that a practice of taking security in respect of certain types of obligation *ad factum praestandum* emerged. This had consequences for the drafting of the new legislation on heritable securities.

The 1970 Act

2.12 Like the development of the older law, the inclusion of obligations *ad facta praestanda* within the scheme of the 1970 Act was not a straightforward matter. The recommendations of

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[16] K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 10. See also Reid, *Property* para 391.
[17] K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 10. See also Reid, *Property* para 423.
[18] Gloag and Irvine, *Rights in Security* 166; K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 10.
[19] K G C Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 11-12, citing cases including *Clark v City of Glasgow Life Assurance* (1850) 12 D 1047, *Marquis of Tweeddale's Trustees v Earl of Haddington* (1880) 17 R 620 and *Anderson v Dickie* 1915 SC (HL) 15.
[20] (1840) 1 Rob App 296 at 306-307.
[21] Ibid.
[22] See, for example, Gloag and Irvine, *Rights in Security* 166-167.
[23] Reid, "What is a Real Burden?" (1984) 29(1) JLSS 9 at 10-11.
[24] 2003 Act s 2(1).
[25] Gloag and Irvine, *Rights in Security* 67-68; see also 170-172.
[26] Gloag and Irvine, *Rights in Security* 167.

the Halliday Committee, which underpinned the development of the Act, made no reference to such obligations. Archival material suggests that this matter was instead placed on the radar of government officials working on the Bill which became the 1970 Act by parties with whom they consulted during its preparation.

2.13 A note of a meeting between Professor Halliday and various government officials on 13 December 1968 records the following discussion:[27]

> "Mr Mitchell [the legislative draftsman] mentioned the difficulties he was in trying to provide a flexible type of security which could cover all kinds of obligations including non-monetary obligations. You will recall this was a point put to us by some of the consulted parties. Professor Halliday expressed his own serious doubts about the need to provide for non-monetary obligations. He himself had some difficulties in envisaging the circumstances where in practice such an obligation would be created."

2.14 There is nothing in the note to make clear who "the consulted parties" were. Some light is shed, however, by subsequent correspondence intended to follow up with "the contact men of the organisations who made this point."[28] On 18 December 1968, letters were issued by a government official to three solicitors in Glasgow and Edinburgh, noting the difficulties experienced by the draftsman and asking for clarification of the extent to which non-monetary obligations were entered into in practice.[29] The archive contains a response from only one of the recipients.[30] Initially, he notes that security is sometimes taken in relation to the types of non-monetary obligations often ancillary to a loan, such as the obligation to maintain the property in which a security is held. Here he remarks, perhaps in reference to the meeting between consulted parties in which "this point was put to us" as mentioned above:

> "I must say that when we discussed the matter in St Andrew's House I did not see why there should be difficulty and I still do not see why there should be difficulty in connection with the wording of the proposed Statute. The Statute makes provision for the form of the security documents and for "standard conditions". I take it it would be proposed also that the lenders would be allowed to vary the standard conditions and to insert other conditions in their security documents. The non-monetary obligations, including obligations ad factum praestandum which you had mentioned would merely be made conditions of the loan. The remedy of the lender, if the conditions were not observed, would be to call for repayment. I do not believe you can expect to achieve more than this."

2.15 The consultee goes on to consider circumstances "where there is no loan." Here, he notes that it has become common for companies to "secure over their heritage debentures or debenture stock issued by an associate company or a parent company." He also indicates the desire of some companies to provide heritable security in respect of obligations owed to

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[27] See NRS HH41/1891: Note of meeting at Lord Advocate's Department on 12 December 1968.
[28] Ibid.
[29] NRS HH41/1891: Letters from G R Wilson of the Scottish Home and Health Department to J Pollock, solicitor; W D Prosser, solicitor; and A J Ambrose, solicitor dated 18 December 1968. The archive does include correspondence between the Scottish Home and Health Department and other consultees, namely the Board of Trade, Registers of Scotland, Midlothian County Council, the Inland Revenue and financial institutions. There is no explicit discussion of the treatment of non-monetary obligations in relevant correspondence or notes of meetings involving these consultees, however.
[30] NRS HH41/1891: Letter from J Pollock, solicitor to G R Wilson of the Scottish Home and Health Department dated 23 December 1968.

another company in the same group, such as a guarantee or an undertaking to take up shares. There is no mention of how such an obligation might be enforced through the exercise of the security. It is worth noting, however, that the obligations referenced ultimately involve the payment of money, for example to repay sums advanced as debenture stock or to take up shares. Accordingly, realisation of the security property through sale would appear an equally apt remedy for obligations of this type as for debts.

2.16 Further discussion between officials and Professor Halliday appears to have followed. In a letter of 9 January 1969, an official in the Scottish Home and Health Department reports to others the suggestion of Professor Halliday that the new form of heritable security "should be geared specifically to the most common type of transaction", namely for a capital loan.[31] The proposal was that the whole Bill should be drafted on this basis, "but that there should be a general provision added saying it would be permissible to use the new form of security also for other types of obligation (annuities and obligations *ad factum praestandum*)." As we know, this was the approach ultimately taken by the drafters.

2.17 There is nothing more in the archives to assist with understanding the treatment of obligations *ad facta praestanda* in the legislation. The Notes on Clauses relating to the Bill as introduced into Parliament offer the following commentary:[32]

> "[An obligation ad factum praestandum] is an obligation to do some act. For example, a firm might undertake to complete a contract by a specific time and as security for their fulfilling this obligation might grant security over part or all of their property. Such transactions might also have a financial penalty clause written into them and the extent of the security may also be related to the amount of the penalty. This type of transaction is catered for within the framework of the new form of security."

2.18 It is difficult to draw clear conclusions from the above about the intention behind the drafting of the 1970 Act in relation to obligations *ad facta praestanda*. One interpretation is that the Act provides no remedies in relation to obligations where payment of money could not equate to performance because it was not anticipated that such obligations would be secured. The examples of obligations *ad facta praestanda* discussed in the archival materials are those in which money would allow for performance of the obligation, for example in facilitating the purchase of shares. In other cases, it may have been anticipated that a contract for a primarily non-monetary obligation would specify an alternative monetary obligation in the event of failure to perform, as is arguably envisaged by the Notes on Clauses. A second possible understanding of the approach taken to the legislative drafting, perhaps supported by the correspondence on 9 January 1969, is that the difficulty with enforcing non-monetary obligations was recognised. However, a decision was taken not to provide specific statutory remedies in this respect to avoid complexity in the legislation. If this interpretation is correct, the archival materials do not reveal how it was thought this difficulty might be addressed outwith the legislation. Perhaps it was hoped that case law or practice might develop a solution.

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[31] NRS HH41/1891: Letter from G R Wilson of the Scottish Home and Health Department to Mr Cowperthwaite of the Scottish Home and Health Department and Mr Dalgetty, Solicitor for the Secretary of State for Scotland dated 9 January 1969.
[32] Notes on Clauses (clause 8).

Current law

2.19 In keeping with the drafting approach suggested above, the 1970 Act says very little about security for obligations *ad facta praestanda*. As previously noted, the definition of debt includes any obligation *ad factum praestandum*.[33] Schedule 2 to the Act sets out the two statutory forms for creation of a standard security. Form A, in which the secured obligation and the security itself are created in the same deed, envisages that the obligation will be monetary.[34] Note 7 of the Schedule suggests broadly that, "In the case of a standard security for a non-monetary obligation, the forms in this Schedule shall be adapted as appropriate". No further specific reference to obligations *ad facta praestanda* (or, indeed, to non-monetary obligations) is found in the statute.

2.20 The only reported case we have been able to identify involving an *ad factum praestandum* standard security is *J H & W Lamont of Heathfield Farm v Chattisham Ltd*.[35] The secured obligation in this case arose from an option agreement by which the pursuer undertook to transfer ownership of land to the defender where various conditions were met. The agreement provided that after a specific date, if fewer than ten acres of the land in question had been allocated for development by the planning authority, either party could resile from the agreement without penalty.[36] After the specific date, the pursuer gave notice to terminate the agreement on this basis and sought a discharge of the security held by the defenders.[37]

2.21 A key issue in the case was the extent of the secured obligation. Did the security relate only to the primary obligation in the agreement, namely to transfer ownership of land, or also to secondary obligations concerning penalties for breach of various terms?[38] It was found to be clear from the wording of the security that only the primary obligation was secured.[39] Since this obligation had been terminated by service of the pursuer's notice, it followed that the accessory standard security was also brought to an end. The pursuer was therefore entitled to the discharge.[40] A second argument concerned whether the defenders were entitled to withhold performance of their obligation to discharge on the basis of alleged breaches by the pursuer of secondary obligations in the agreement. Since the obligations breached were not a counterpart of the obligation to discharge, no right of retention of performance was found to arise here.[41] The defenders remained free to pursue damages or other remedies under the contract, but these claims were not secured by the standard security. There was no discussion in the case of how the security might have been used to enforce the primary obligation itself.

Modern commentary

2.22 Above, we noted that the key difficulty with the concept of security for obligations *ad facta praestanda* is the mismatch between performance of the secured obligation and the

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[33] 1970 Act, s 9(8).
[34] The form being, "I, A.B. (*designation*), hereby undertake to pay to C.D. (*designation*), the sum of £ (*or* a maximum sum of £) (*or* all sums due and that may become due by me to the said C.D…"
[35] [2017] CSOH 119 aff'd [2018] CSIH 33, 2018 SC 440.
[36] [2018] CSIH 33 at [2].
[37] [2017] CSOH 119 at [2].
[38] [2017] CSOH 119 at [40]; [2018] CSIH 33 at [9].
[39] [2017] CSOH 119 at [41]-[42]; [2018] CSIH 33 at [9].
[40] [2018] CSIH 33 at [22].
[41] [2018] CSIH 33 at [18-21] (Lord Carloway); [34] (Lord Drummond Young). For critical comment on the analysis of retention in the Inner House, see L Richardson, "What do we know about retention now?" (2018) 22(3) Edin LR 387-393.

remedies available under the security. In DP1,[42] we explained that this question was first aired in an essay by Professor Gretton in 1987:[43]

> "[I]t is unclear to me how securities for obligations *ad facta praestanda* are supposed to work. A right in security, when realised, will produce money. This will satisfy a money obligation. But it will be irrelevant to an obligation *ad factum praestandum*…This problem is particularly obscure if the obligation contains no clause of liquidated damages. Suppose a standard security *secundo loco* [second ranking] is granted for an obligation *ad factum praestandum* and there is default on the *primo loco* [first ranking] security, which leads to sale. What is to happen to the free proceeds?"

2.23 Here, Professor Gretton identifies not only the inaptitude of monetary remedies to secure performance of a non-monetary obligation, but also the connected difficulty of ranking. The law in this area does not envisage ranking between or amongst securities which cannot be quantified in money.[44]

2.24 Professor Gretton goes on to suggest that what may actually be secured by an *ad factum praestandum* security is the sum due in damages for non-performance of the obligation.[45] This view was reiterated more recently in his commentary with Professor Reid on *J H & W Lamont of Heathfield Farm*.[46] They suggest that a security must provide some mechanism for enforcing a non-monetary obligation or else it would be "like a control switch on a machine that is disconnected."[47] Referring to the suggestion that what is actually secured is damages for non-performance, they write that "no other view seems possible".[48]

2.25 While this approach may well be the best that can be made of the current legislation, it is not without difficulties. One question is how the sum secured is to be ascertained in this construction of the legislation, though as Reid and Gretton point out, decree could be sought to this effect in the process of exercising the security.[49] Another concern is whether the debtor in the secured obligation might be entitled to obtain a discharge of the security at any point prior to default on the obligation since, at that point in time, no debt in damages is actually owed.[50] The 1970 Act allows for security to be taken in respect of future and contingent obligations, but whether *ad facta praestanda* securities are routinely drafted in such a way as to fall within that definition, or otherwise to avoid being subject to redemption under the complex rules in the 1970 Act, is difficult to assess.

2.26 Reform of standard securities legislation must address the fundamental conceptual difficulties identified here. Before considering how best to do so, it is first necessary to take

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[42] DP1 para 4.39.
[43] G L Gretton, "The Concept of Security" in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 126 at 128-129.
[44] Rules of ranking amongst securities are discussed in DP2 paras 3.4–3.20.
[45] G L Gretton, "The Concept of Security" in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 126 at 128-129.
[46] [2017] CSOH 119 aff'd [2018] CSIH 33, 2018 SC 440.
[47] K G C Reid and G L Gretton, *Conveyancing 2017* (2018) 137.
[48] Ibid. This view has been accepted by other writers: see D J Cusine and R Rennie, *Standard Securities* (2nd edn, 2002) 28; A J M Steven and S Wortley (eds) *Professor McDonald's Conveyancing Manual* (7th edn, 2004) para 21.4.
[49] K G C Reid and G L Gretton, *Conveyancing 2017* (2018) 137.
[50] Redemption is provided for in the 1970 Act, s 18 and standard condition 11. See the discussion in DP1 paras 11.15-11.39.

into account the ways in which *ad factum praestandum* security is proving useful in current practice.

Ad facta praestanda securities in practice

2.27 In DP1, we set out a number of cases in which standard securities are provided in respect of obligations *ad facta praestanda* in current practice.[51] Additional examples emerged in responses to the consultation on DP1. The following is a cumulative list of the cases which we have been able to identify:

(1) A contractual right of first refusal to acquire land on the owner deciding to sell (a pre-emption);

(2) The obligations of a land owner under an option agreement with another party for that party to acquire or take a lease of the land;

(3) The obligations of a seller of land under a contract of sale which is subject to suspensive conditions (eg to provide support and assistance to the purchaser to obtain planning permission);

(4) The obligations of a landlord under a lease to the tenant which may not be *inter naturalia* of the lease and therefore not binding on the landlord's singular successors;[52]

(5) The obligations of a recipient of a grant to carry out works to its property funded by the grant;

(6) Overage or "clawback" obligations owed to a seller of land by its buyer in relation to the potential increase in value of that land where certain conditions are met (for example, planning permission is obtained);

(7) Obligations owed under a promotion agreement to make payments when various milestones in a development agreement (eg grant of planning permission) are achieved;

(8) The obligations of a buyer of land from a local authority or public body to fulfil the conditions on which the transfer was granted (for example, to construct a car park);[53]

(9) The obligation on a land owner to construct a house where payment is made in advance for the construction but title will not transfer until construction is complete.[54]

2.28 In several of the cases above, it seems clear that the purpose of taking the security is to ensure payment of money. This is the position where security is taken in respect of overage

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[51] DP1 para 4.36.
[52] For example, *Ross v Duchess of Sutherland* (1838) 6 S 1179 (landlord's agreement to reduce the rent in return for work carried out by the tenant not binding on successor landlord). The question of transmission of lease terms against singular successors of the parties is a focus in the current phase of our project on *Aspects of Leases*.
[53] Cusine and Rennie, *Standard Securities* para 3.05.
[54] *The Laws of Scotland: The Stair Memorial Encyclopaedia* vol 20 (1992) para 148 (J Burgoyne).

obligations, for example. This is arguably also the intention in relation to obligations to carry out grant-funded works or to construct a house, for example, since breach of these obligations will entitle the creditor to repayment of funds advanced and/or to damages. We think cases of this type may be catered for relatively straightforwardly within the standard security framework, by clarifying in any new legislation either that the obligation secured or the entitlement of the holder to remedies under the security are wholly financial in nature. In Chapter 3, we consider what provision may be required within any new legislation on standard securities to ensure that *ad facta praestanda* securities, within these constraints, are adequately catered for.

2.29 The second category of cases discernible from the list is more difficult. These are cases in which the secured obligation concerns the transfer of land or grant of a subordinate real right, such as in examples (1) – (3) above. In this situation, we understand that the purpose of taking security is to give a form of third-party effect to the secured obligation by making it visible on the Land Register. This publicity will, in some circumstances, allow for a transfer of land or grant of a subordinate real right in breach of the obligation to be reduced by the creditor under the so-called rule against offside goals.[55] Reforming the law to address this category of case raises complex questions about the extent to which such obligations should be enforceable against third parties and the mechanism appropriate to provide that protection. We address these questions, and give detailed consideration to a new form of advance notice by which conditional obligations to transfer land (or grant a subordinate real right therein) may be protected, in Chapter 4.

[55] *Rodger (Builders) Ltd v Fawdry* 1950 SC 483 is the leading modern authority in the case of heritage. Detailed discussion and reference to commentary can be found in DP1 paras 8.12-8.19.

Chapter 3 Securing non-monetary obligations

Introduction

3.1 In Chapter 2, we considered the background to standard securities for obligations *ad facta praestanda*. We noted that, in many cases, the financial remedies available under a standard security will suffice to ensure performance of the relevant obligation. This may be because payment of damages by the debtor will allow for fulfilment of the secured obligation, or because damages in compensation for breach of the obligation will meet the needs of the creditor.

3.2 The treatment of securities of this kind in the 1970 Act is not clear. In this Chapter, we consider what is required of any new legislation on standard securities to make appropriate provision for secured obligations falling into this category.

What is secured?

3.3 In our first Discussion Paper in this project, we gave detailed consideration to the types of obligation capable of being secured by a standard security, including obligations *ad facta praestanda*.[1] We noted the view that what is really secured in an *ad factum praestandum* security is damages for breach of the underlying obligation. In our summary of the law in a number of other jurisdictions,[2] we could not find any comparator in which a heritable security could secure a non-monetary obligation in the broad terms in which this is permitted by the 1970 Act. However, we did identify a number of jurisdictions in which security could be taken in respect of an expressly provided damages claim for breach of a non-monetary obligation.[3]

3.4 We then suggested two possible options for reform of the law.[4] The first option would be to provide, in any new legislation, that standard securities could *not* secure a non-monetary obligation. It would remain possible to secure a damages claim for non-performance of an obligation under this model, and we suggested that parties might wish to stipulate exactly what damages would be due in the interests of certainty. However, the non-monetary obligation itself would not be secured. The second option would be to allow for a standard security to be taken for a non-monetary obligation as at present, but to provide in legislation that what is actually secured in such cases is payment of damages where the obligation is not performed. We noted one potential advantage of this second approach as being that existing security documentation could continue to be used without revision.

3.5 Of the 21 consultees who responded to this question, seventeen preferred the second option.[5] However, many of those respondents expressed the view that this was the only viable option since no alternative mechanism for the protection of obligations to transfer land was

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[1] DP1 ch 4.
[2] DP1 paras 4.45-4.65.
[3] DP1 paras 4.54 (Hungary), 4.55 (Louisiana), 4.57 (India) and 4.61 (South Africa).
[4] DP1 paras 4.66-4.73 and question 13.
[5] One consultee preferred the first option. The remaining three consultees expressed no clear view.

available or proposed. Two amongst these consultees explicitly stated that the first option would be preferred should such a mechanism be introduced.

3.6 Partly as a result of these consultation responses, we have gone on to consider in detail a potential alternative mechanism for protection of obligations to transfer land. That consideration is set out in Chapter 4 of this Discussion Paper. Since many of the responses we received to DP1 set out a view contingent on the existence or otherwise of such a mechanism, we think it is appropriate to give consultees an opportunity to offer an updated opinion in light of our further work.

3.7 Before we do so, we think it may be useful to address some other concerns expressed by respondents to DP1 in connection with the suggestion that a standard security might secure the obligation to pay damages for non-performance of a non-monetary obligation. First, we do not think it would be necessary for a specific figure in damages to be identified at the time the security is granted. The current law does not require any secured obligation to be for a fixed sum,[6] and security for variable amounts of debt is common, as where security is taken for an overdraft. In DP1, we proposed the same approach should be taken in any new legislation,[7] and that proposal was universally supported by consultees. We think a standard security under any new legislation could therefore be validly constituted in respect of a damages claim where the value of that claim was yet to be determined. As with any security in respect of a variable debt, relevant parties may seek to agree the value of the obligation secured on exercise of the security or when entering a ranking agreement. Alternatively, a determination by the court may be sought.

3.8 Secondly, if the obligation secured is payment of damages for non-performance, it was suggested to us that the security could be redeemed at any point prior to breach occurring, since no debt in damages would be owed at that time. While the position in this respect under the current law may be difficult to discern, we think future legislation can make appropriate provision to avoid this outcome.

3.9 The current rules on redemption and discharge of standard securities are less clear than they might be.[8] A security will be extinguished automatically where the secured obligation is extinguished, for example through prescription, and a debtor is entitled to a discharge to update the Register in that circumstance.[9] Alternatively, a debtor may redeem the security by performing the whole obligations due under it and otherwise complying with the redemption procedure set out in the Act. If this is done, the creditor is obliged to provide a discharge.[10] In DP1, we proposed that a debtor should be entitled to a discharge on the secured obligation being performed in terms of the contractual arrangements between the parties.[11] This proposal was strongly supported by consultees. We also asked whether a debtor under an all sums security should be entitled to a discharge where there is no outstanding debt.[12] Views on this issue were divided.

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[6] 1970 Act s 9(3) and 9(8)(c), discussed in DP1 paras 4.11-4.13.
[7] DP1 para 4.33.
[8] Redemption is covered in the 1970 Act s 18 and standard condition 11. Discharge is dealt with in the 1970 Act s 17. For general discussion, see DP1 paras 11.5-11.43.
[9] DP1 paras 11.2-11.9.
[10] DP1 paras 11.15-11.39.
[11] DP1 para 11.39.
[12] DP1 para 11.12.

3.10 Assuming the discharge provisions in any new legislation follow the line supported by consultees, the default rule will be that a debtor is entitled to a discharge only following performance of the secured obligation in terms of the contractual arrangements between the parties. If the obligation secured is a conditional obligation to pay damages for breach, performance could take place only if and when the condition was fulfilled. Performance would not be due prior to the fulfilment of the condition, but that would not provide an entitlement to discharge. Should any exception to this default discharge rule be thought appropriate, for example to entitle a debtor to discharge of an all sums security where there is no outstanding debt, this could be carefully drawn in the legislation to ensure that contingent damages obligations remained subject to the default rule.

3.11 In discussion with our Advisory Group, it was questioned whether specifying a damages claim in a contract might result in the creditor being unable to obtain decree for implement of the obligation in the event of non-performance. As we noted in our Discussion Paper on Remedies for Breach of Contract,[13] in Scots law, an order for specific implement of a non-monetary obligation is available to a creditor as of right, subject to a number of exceptions.[14] The court has a residual discretion to refuse the remedy, though only in exceptional circumstances where its grant would be inconvenient and unjust, or cause exceptional hardship.[15] The adequacy of damages will be one factor the court takes into account in making this assessment.[16] This contrasts with the position in England and Wales, where the equivalent remedy of specific performance will be granted only where it is equitable to do so, and not if damages is an adequate remedy in the situation.[17] If legislation were introduced to the effect that a standard security may only secure a damages claim for non-performance of a non-monetary obligation, the need for parties to cater for this within the contractual agreement would point away from any intention on their part that damages would be adequate or preferable to implement. This issue could also be addressed in the contractual drafting.

3.12 In short, we do not see any difficulty in principle with a standard security being taken in respect of an obligation to pay damages for non-performance. However, we would be grateful for the views of consultees. In light of the developments since DP1 outlined above, and bearing in mind the proposals set out elsewhere in this Discussion Paper, we ask:

2. Which of the following approaches do consultees prefer and why?

(a) A standard security may not secure a non-monetary obligation, but it may secure an obligation to pay damages for non-performance of that obligation.

(b) A standard security may secure a non-monetary obligation, but the security will entitle the holder only to damages for non-performance of that obligation.

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[13] Scottish Law Commission, Discussion Paper on Remedies for Breach of Contract (DP No 163, 2017).
[14] Scottish Law Commission, Discussion Paper on Remedies for Breach of Contract (DP No 163, 2017) para 6.17. Crown Proceedings Act 1947 s 21(1) provides that the remedy is not available as of right against the Crown. Exceptions typically arise where performance of the contract would be impossible or the contract is one involving a highly personal relationship such as employment.
[15] *Highland and Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297 at 311 per Lord Kingarth.
[16] W M McBryde, *The Law of Contract in Scotland* (3rd edn, 2007) paras 23.10 to 23.12; 23.21.
[17] H G Beale (ed), *Chitty on Contract*s (34th edn, 2021) paras 30.018 to 30.032.

Ranking

3.13 The second issue we identified in connection with security for obligations *ad facta praestanda* concerns ranking. In DP1 we pointed out the following concern:[18]

> "When the [security property] is sold either by the security holder or, as in Professor Gretton's example, by the holder of another security over the property, how is a security to rank if it is for other than a monetary sum?"

3.14 Since then, we have learned more from practitioners about how these issues are dealt with in current practice. We understand one common approach to ranking in cases where a property is subject to one or more monetary securities alongside a non-monetary security in relation to an option or similar is to provide that the non-monetary security ranks last, but to agree that the option holder retains a right to exercise the option in the event of default. The effect is that the option holder may purchase the security property on default should it wish to do so, with the proceeds of that sale applied in satisfaction of the debts of the monetary security holders in line with their priority in ranking. We have also learned of more complex ranking agreements entered into, for example, where a non-monetary security covers overage payments which may fall due on a staggered basis into the future. We do not think it is feasible, or desirable, to suggest that legislation might attempt to set out rules for complex situations of this kind.

3.15 In effect, the challenges to ranking we identified in DP1 fall away as a result of our approach to reform of the law in this area. We previously noted the two categories into which *ad facta praestanda* securities can be divided in current practice: those in which a monetary remedy will meet the needs of the creditor, and those in which the security is intended to protect an obligation to transfer land.[19] The first category of security can be accommodated within the usual rules of ranking without the need for specific reform. The second category of security will, under our proposals, cease to exist, since an alternative mechanism for protection of obligations to transfer land will be introduced. Accordingly, no reform to rules of ranking is required in that respect either.

3.16 We seek views above on reforms that would clarify in any new legislation the financial nature of the entitlement of an *ad factum praestandum* security holder. As under the current law, we think it will be common, where more than one security has been taken over the same property, for security holders to enter into a ranking agreement. In that process, parties may seek to agree the value (or a method for calculation of the value) of any secured obligation the value of which is not fixed at the time the agreement is entered into. If not, on exercise of the security, the value of the damages claim may be agreed by the parties to it or determined by the court, just as the extent of an outstanding debt under a monetary security is agreed by the parties or determined by the court. Again, we do not think that any specific provision will be required in any new legislation to accommodate arrangements of this kind where *ad facta praestanda* securities are involved.

3.17 We recognise, of course, that practice in this area is complex, and there may be examples we have not considered in which specific provision in future legislation would be of

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[18] DP1 para 4.40.
[19] See paras 2.27 to 2.29 above.

benefit. We would be particularly grateful to hear of practitioners' experiences in that respect in response to the question below. We ask:

3. If a standard security under any new legislation entitles its holder only to monetary remedies:

(a) Is specific provision required to deal with the ranking of such a security?

(b) If so, what provision is required?

Chapter 4 Protecting obligations to transfer land

Introduction

4.1 In the previous Chapter, we dealt with *ad facta praestanda* securities in which the financial remedies available under a standard security would suffice to secure the obligation to the creditor's satisfaction. However, a financial remedy will not suffice in cases where the purpose of taking the security is to protect an obligation to transfer land, or to grant a subordinate real right in land, against a competing grant. In this Chapter, and the one which follows, we consider the protection of such future and conditional obligations.

4.2 As explained in Chapter 2, the grant of a standard security is often sought from a landowner in respect of obligations they have undertaken in an option agreement or similar contract related to their property.[1] Once entered on the Land Register, the security provides notice to third parties of the existence of the obligations. The title of a third party who acquires ownership of the land or a subordinate real right from the owner in breach of the agreement may be subject to reduction at the instance of the option holder on the basis of the so-called rule against offside goals, assuming the other conditions of that rule have been satisfied.[2] In practice, the security will make breach of the agreement less likely, since a potential acquirer will usually be deterred by the existence of the security even if its precise effects are unclear.

4.3 The question of whether, and how, the law should protect contractual obligations of this kind against competing grants is not strictly a matter of the law of heritable securities. We have given consideration to this topic previously in our projects on Real Burdens[3] and Land Registration.[4] There is also an argument that the issue would be better addressed as part of a broader reform of the offside goals rule itself.[5] In practice, however, standard securities have emerged as the mechanism by which such obligations are currently protected. Following consideration of the responses to DP1, we came to the view that the law of heritable securities will not be complete if this issue is not tackled, hence our decision to deal with it within the context of this project.

4.4 Below, we consult on a detailed scheme to protect the priority of future and conditional obligations to transfer land or grant a subordinate real right based on the advance notice system introduced under the Land Registration etc. (Scotland) Act 2012. Before considering the detail of these proposals, we address two preliminary questions. The first is whether, as a matter of principle, Scots law should provide any such protection. The second is whether the current mechanism for obtaining this protection is sufficient or requires reform. Our consideration of this topic concludes in Chapter 5, where we review other potential

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[1] See para 2.27 above.
[2] See para 2.29 above.
[3] Scottish Law Commission, Report on Real Burdens (Scot Law Com No 181, 2000) Ch 10.
[4] Scottish Law Commission, Report on Land Registration (Scot Law Com No 222, 2010) paras 14.58-14.60.
[5] DP1 para 8.20.

mechanisms for protecting this type of obligation, such as real burdens and inhibitions, and explain why we think they are less appropriate than a conditional advance notice scheme.

4.5 We now turn to the two preliminary questions mentioned above. In the discussion which follows, we focus on the protection of obligations to transfer land since we understand these to be the obligations most commonly protected in this way. However, the same principles apply in relation to obligations to grant a lease or a servitude, for example.

A (property law) mechanism to protect (contractual) land obligations?

4.6 In Chapter 2, we set out the background to the inclusion of obligations *ad facta praestanda* within the scheme of the Conveyancing and Feudal Reform (Scotland) Act 1970. We found no real evidence to suggest that the drafters of that legislation envisaged the use of standard securities to protect obligations to transfer land. The practice of taking a standard security to set up a claim under the offside goals rule – or simply to stake a claim to a "seat at the table" in discussions where a dispute arises – is an innovation.

4.7 Our understanding from discussions with practitioners working in this area is that, over a number of decades, this innovative use of standard securities has become routine in certain types of complex property transaction. It has been explained to us that the ability to secure an option or similar obligation to transfer land is essential in structuring land assembly transactions. These transactions in turn underpin a significant amount of residential, commercial and industrial property development in Scotland. If it were not possible to protect obligations of this type other than through damages for breach, developers and their funders may be deterred from working on large scale projects of this kind. Where the aim is to assemble several plots of land into one large parcel, the loss of one piece of the jigsaw cannot be cured with damages – what is needed is the land itself.

4.8 The uses to which *ad facta praestanda* standard securities are currently put in practice are an important factor when considering reform of the law. However, it is also necessary to take into account the difficult policy questions which arise here. The policy underlying the law in this area arguably has not received appropriate scrutiny to date precisely because practice has evolved in a way that was not foreseen. This project provides an opportunity to correct that omission.

4.9 The value of a standard security taken in respect of an obligation to transfer land is that it provides a protection going beyond the usual contract law remedies.[6] An obligation arising under a contract or otherwise can generally be enforced only against the debtor. Where a standard security is taken in respect of the obligation, the publicity given to the obligation on the Land Register provides the creditor with a remedy against any third party where the other conditions of the offside goals rule are met. This effective constraint on the power of the owner to transfer good title to land, enforceable against the world, turns a straightforward contractual right owed by the owner to the creditor into a mechanism straddling the boundary between contract and property law.

[6] The primary remedies here are implement, interdict and damages.

4.10 The key risk of such a mechanism is that land may be rendered unusable due to disputes between parties with a claim to it. Scots law, in common with many legal systems,[7] has a *numerus clausus* (fixed list) of rights that can be held in property.[8] Parties are not free to invent their own property rights and obligations in the way they may do with contracts. One reason for the fixed list is to prevent property, especially land, becoming tied up in disagreements between the various people who hold rights in it.[9] Land is both an essential and a finite resource, meaning it is in the interests of everyone in the jurisdiction for it to be used well.[10] Property law therefore tends to limit the flexibility that may lead to disputes, to reduce the risk of land becoming effectively unusable or "sterile".

4.11 The risk of sterilisation may be particularly acute where disputes relate to central aspects of what it means to own land. The power of an owner to transfer that ownership to another person may be regarded as one of the most important rights stemming from title. A mechanism the effect of which is to enable a contractual obligation to restrict or wholly prevent the exercise of this key ownership right may therefore have particularly adverse consequences in relation to land. It may, of course, be argued that an individual owner has the right to restrict their ownership powers in this way if they so choose. However, the finite nature of land as a resource means that the effects of these individual choices by landowners can have repercussions for society as a whole. Accordingly, the law must be careful about how far it permits an owner to restrict the powers attaching to ownership.

4.12 The need for caution here does not, in our provisional view, result in an absolute barrier to a property-law-based protection of obligations to transfer land. A middle ground can be found. The clearest evidence in support of this view is, of course, current practice. *Ad facta praestanda* securities have been used to provide a protection of this kind for decades, and we do not understand this to have produced deleterious effects on the land market. Indeed, if a reformed law of standard securities prevented their use in this way without providing an adequate replacement, it would represent a substantial disruption to the status quo which would likely have deleterious effects of its own. Moreover, property-based mechanisms for protection of land obligations are familiar in comparator jurisdictions. The *Vormerkung* (priority notice) of German land registration law, which offered a partial template for the Scottish advance notice system,[11] allows for protection of a range of future and conditional land obligations.[12] In England and Wales, a restriction can be entered in the proprietorship register

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[7] For a detailed discussion of this principle with a focus on the law of France, Germany, the Netherlands and England and Wales, see B Akkermans, *The principle of numerus clausus in European property law* (2009).
[8] Reid, *Property* paras 4-5; R M Paisley, "Real rights: practical problems and dogmatic rigidity" (2005) 9(2) Edinburgh Law Review 267-292 at 267-270; G L Gretton and A J M Steven, *Property, Trusts and Succession* (4th edn, 2021) para 2.8.
[9] For broad discussion of this benefit of the *numerus clausus* principle in property law see, for example, B Rudden, "Economic theory v property law: the numerus clausus problem" in J Eekelaar and J Bell (eds), *Oxford Essays on Jurisprudence* (3rd edn, 1987) 239-310; T W Merrill and H E Smith, "Optimal standardization of the law of property: the numerus clausus principle" (2000) 110 Yale Law Journal 1; B Akkermans, "Standardisation of property rights in European property law" in B Akkermans, E Ramaekers and E Marais (eds), *Property Law Perspectives II* (2013) 221-248; M Heller, "The tragedy of the anticommons: a concise introduction and lexicon" (2013) 76(1) Modern Law Review 6-25.
[10] This policy goal is now explicitly recognised: see Scottish Government, *Land Rights and Responsibilities Statement 2022* (2022), Vision.
[11] See para 4.23 below.
[12] BGB § 883-888. For an overview, see G Dannemann and R Schulze (eds), *German Civil Code: Article-by-Article Commentary* (2020) 1728-1739.

which prevents the registration of any deed in relation to a plot of land that does not comply with the terms of an option agreement.[13]

4.13 Our provisional view is therefore that a property-law-based protection of obligations to transfer land should continue to be available following any reform to the law of standard securities. In considering reform, we think it will be essential to bear in mind the policy concerns outlined above. In our view, a cautious path should be taken to minimise the risk of disturbing the existing balance between contract law and property law in our legal system, which in turn may impact on the land market and, ultimately, on the productive use of land. However, we think it is possible to make successful reform proposals whilst bearing in mind these concerns.

4.14 We would be grateful for the views of consultees. We ask:

4. Should the law provide a means by which contractual obligations to transfer or grant subordinate real rights in land can be protected beyond the usual contractual remedies?

Maintaining the status quo?

4.15 Consultees may disagree with our provisional view on the preliminary question above, in which case the discussion in the remainder of the Chapter will be unnecessary. However, based on responses to questions on this topic in DP1 and discussions with our advisory group, we do not anticipate that this will be the case. If consultees agree that it should be possible to protect contractual obligations to transfer or grant subordinate real rights in land beyond the usual remedies, the next question is how that protection should be provided. Will the status quo suffice?

4.16 Earlier in this Paper, we set out the challenges to which the current practice in this area gives rise. First, standard securities were not designed to protect title against competing deeds. Creditors in obligations to transfer land take a standard security as a means of acquiring protection under the offside goals rule, not because they wish to make use of the remedies the security provides. This mismatch between the design of a standard security and the purpose of taking a security in these cases seems to us contrary to principles of legal clarity and accessibility. In short, it is a clumsy solution.

4.17 In addition, the offside goals doctrine on which creditors rely in an arrangement of this type may itself be criticised for lack of clarity.[14] The policy underlying the rule is a matter of academic debate.[15] The exact parameters of the rule are unknown.[16] A solution which does

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[13] Land Registration Act 2002 ss 40-47. For an overview, see S Bridge, E Cooke and M Dixon, *Megarry and Wade: The Law of Real Property* (9th edn, 2019) paras 6-077 to 6-084.

[14] For an overview of the offside goals rule and citation of relevant case law, see Reid, *Property* paras 695-700. More recent discussion can be found in P Webster, *Leasehold Conditions* (2022) paras 9-04 to 9-09.

[15] Among others, possible rationales include the publicity principle of Scots property law and the protection of creditors against fraud. For examples of contributions to the debate, see: S Wortley "Double Sales and the Offside Trap: Some thoughts on the rule penalising private knowledge of a prior right" 2002 JR 291; J MacLeod, *Fraud and Voidable Transfer* (2020) paras 7-39 to 7-95.

[16] See, for example, J MacLeod "The Offside Goals Rule and Fraud on Creditors" in F McCarthy, J Chalmers & S Bogle (eds), *Essays in Conveyancing and Property Law in Honour of Professor Robert Rennie* (2015) 115-140 at 139 questioning the extent of the good faith requirement of the rule and R G Anderson and J McLeod, "Offside goals" 2009 SLT (News) 93 querying the extent of the duty of inquiry which must be discharged by a party aiming to remain in good faith in terms of the rule. Criticism of the expansion of the rule more broadly can be found in R Rennie, "Marching towards equity – blindfolded" 2009 SLT (News) 187-192.

not rely on this doctrine would seem preferable, from the perspective of legal certainty, to one which does.

4.18 Reforming the law would allow for a mechanism fit for the intended purpose of protecting the priority of obligations to transfer land. It would improve legal clarity and accessibility at both a conceptual and a practical level, and reduce reliance on the vagaries of the offside goals rule. It should, of course, be recognised that reform also has disadvantages. It will entail disruption, with related resource implications, for parties and their agents, and also for administrative bodies such as Registers of Scotland. However, the disruption caused can be reduced somewhat where reform makes use of established, successful practice, as we think may be appropriate in this case where use can be made of the advance notice system.

4.19 Taking into account all of the above, our provisional view is that the status quo should not be allowed to continue here. Instead, the law should be reformed to introduce an appropriate mechanism to protect the priority of obligations to transfer land or grant subordinate real rights. If consultees disagree with us on this issue, the discussion in the remainder of this Chapter, and in Chapter 5, will be unnecessary. Based on responses to questions on this topic in DP1 and discussions with our advisory group, however, we do not anticipate that this will be the case.

4.20 We would be grateful for the views of consultees. We ask:

5. Which of the following approaches do consultees prefer?

(a) A party wishing to protect the priority of an obligation to transfer or grant a subordinate real right in land should continue to take a standard security in respect of that obligation and rely on the rule against offside goals to protect that obligation.

(b) The law should be reformed to provide a bespoke mechanism for protecting the priority of an obligation to transfer or grant a subordinate real right in land.

Protecting obligations to transfer land: advance notices

4.21 If consultees agree that reform in this area is required, the next question is how best that might be achieved. A number of existing mechanisms within our law could be extended or modified to protect future or conditional obligations to transfer land, or to grant subordinate real rights, against the grant of competing deeds to third parties. For reasons explained further below, our provisional view is that a modified version of the advance notice system is the most appropriate mechanism by which to achieve this goal. We have given detailed consideration to what such a system might look like, and set out provisional proposals in that respect in the remainder of this Chapter. In the following Chapter, we consider other potential mechanisms which could be employed for this purpose, and explain why we did not think it was appropriate to develop those ideas further.

Background

4.22 The advance notice system was introduced by the Land Registration etc. (Scotland) Act 2012[17] to address the problem of "gap risk" in conveyancing transactions.[18] This problem can be illustrated by a simple example. A agrees missives to sell land to B. On the settlement date, B makes payment of the purchase price to A in exchange for delivery of the disposition which will transfer ownership of the land to B. Delivery of the disposition is insufficient in itself to make B the owner of the land. B must take the additional step of registering the disposition in the Land Register for ownership to transfer.[19] Since registration cannot happen instantaneously, a period of days follows during which A remains the owner of the land despite already having acquired the purchase price. In this period, B is vulnerable. If A has secretly delivered a competing disposition to C, and C registers that disposition before B, B will have neither ownership nor the purchase price. The secret disposition to C will breach the terms of the missives between A and B, meaning that B will have a personal right against A. However, that right may amount to little in practice if A has absconded or is insolvent.

4.23 Historically, gap risk was dealt with by the seller's solicitor providing a letter of obligation guaranteeing that no competing deeds had been granted.[20] If this turned out not to be the case, the solicitor's indemnity insurance would cover the costs of the buyer's remedy in damages. Stakeholders expressed serious concerns about the appropriateness of the use of letters of obligation in this context during our project on Land Registration.[21] In response, we recommended the introduction of the advance notice system,[22] which drew on both the "search with priority" system in the law of land registration in England and Wales[23] and the *Vormerkung* (priority notice) of German law.[24]

Operation

4.24 An advance notice operates by protecting the priority of a deed registered in the Land Register (or recorded in the Register of Sasines) during a specific period against competing deeds registered (or recorded) earlier in the same period.[25] In brief, it works as follows. A notice is entered against a property stating that person X intends to grant a deed to person Y in relation to that property.[26] The notice will specify the type of deed in question, for example a disposition or a standard security. If person Y goes on to register the specified deed during the 35 days following entry of the notice – known as the "protected period"[27] – the specified deed will take priority over any competing deed registered during the same period.[28]

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[17] The key provisions are set out in the 2012 Act ss 56-64.
[18] Scottish Law Commission, Report on Land Registration (Scot Law Com No 222, 2010) paras 14.1-14.11.
[19] 2012 Act s 50.
[20] For discussion, and an example of a "classic" letter of obligation, see A Stewart, "A New Era in Conveyancing: Advance Notices and the Land Registration etc. (Scotland) Act 2012" in F McCarthy, J Chalmers and S Bogle (eds), *Essays in Conveyancing and Property Law in Honour of Professor Robert Rennie* (2015) 142-148.
[21] Scottish Law Commission, Report on Land Registration (Scot Law Com No 222, 2010) paras 14.8-14.9.
[22] Scottish Law Commission, Report on Land Registration (Scot Law Com No 222, 2010) ch 14.
[23] Land Registration Act 2002 s 72. For an overview, see S Bridge, E Cooke and M Dixon, *Megarry and Wade: The Law of Real Property* (9th edn, 2019) paras 6-124 to 6-127.
[24] BGB § 883-888. For an overview, see G Dannemann and R Schulze (eds), *German Civil Code: Article-by-Article Commentary* (2020) 1728-1739.
[25] An advance notice also protects against inhibitions and entries having similar effect registered in the Register of Inhibitions during the protected period. We return to this issue below.
[26] 2012 Act s 56.
[27] 2012 Act s 58.
[28] 2012 Act s 59.

4.25 The priority accorded to the protected deed operates according to the principle of "non-opposability".[29] Reid and Gretton explain:[30]

> "The principle can be reduced to two main rules. In the first place, the (later) protected deed has the same effect, on registration, as if the (earlier) competing deed had not been registered at all. In the second place, the original effect of the competing deed is now adjusted to take account of the priority given to the protected deed, but in all other respects is unimpaired."

4.26 The application of these rules will have different results depending on the deeds in question. If both deeds are standard securities, the effect will be that the protected security ranks before the competing security, despite the latter having been registered first. If the protected deed is a disposition and the competing deed is a standard security, the effect is that the security will become invalid from the point at which the disposition is registered. If both deeds are dispositions, again the competing deed will become invalid at the point at which the protected deed is registered.[31] The Keeper will alter the Register to reflect changes which result from registration of protected deeds where appropriate,[32] for example by noting that the protected security ranks prior to the competing security as the result of an advance notice, or by deleting the name of the grantee of the competing disposition from the proprietorship section and entering the name of the grantee of the protected disposition.

4.27 Priority protection against competing deeds may be considered the key effect of an advance notice. However, the notice also provides an additional protection, against the seller's inhibition during the protected period prior to registration of the protected deed. This risk was routinely covered by letters of obligation under the older system.[33] Without the advance notice, a deed granted by the inhibited party subsequent to the inhibition would be subject to reduction *ad hunc effectum* at the instance of the inhibitor.[34] The effect of the advance notice is that the protected deed will not be subject to any inhibition or equivalent adverse entry made in the Register of Inhibitions during the protected period.[35] The notice accordingly provides some protection against the risk of the seller's insolvency during the protected period.

Advance notices: a sui generis security right?

4.28 Rights in security in Scots law may be personal (as with a cautionary obligation) or real (as with a standard security). They may be voluntarily granted (as with a pledge), judicially imposed (as with most forms of diligence) or arise through operation of law (as with certain forms of lien). However, all rights in security are generally understood as mechanisms to ensure the performance of monetary obligations.

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[29] Also known as the principle of "relative invalidity".
[30] Reid and Gretton, *Land Registration* para 10.21.
[31] More detailed examples can be found in Reid and Gretton, *Land Registration* para 10.22 and Registers of Scotland Knowledge Base, *Advance Notices: How It Works* available at https://kb.ros.gov.uk/land-and-property-registration/pre-registration/advance-notices#how-it-works.
[32] 2012 Act s 59(2).
[33] Stewart, "A new era in conveyancing" (n20 above) at 143-145.
[34] See the discussion of inhibition in Ch 5 at paras 5.16-5.22.
[35] 2012 Act s 61(1).

4.29 An advance notice is a mechanism to ensure performance of a different type of obligation. Like a right in security, its existence is accessory to the underlying obligation.[36] Once that obligation is performed, it ceases to exist. Amongst commentators on German law, the *Vormerkung* is commonly categorised as a security instrument *sui generis*.[37] Is the same categorisation appropriate for the advance notice of Scots law, whether under the existing scheme or under the new, conditional form on which we consult below?

4.30 A definitive answer to this question would be likely to require extensive analysis, which we do not think is necessary for the purposes of proposing law reform in this area. However, we mention the issue here, as it may help to answer some questions about how the conditional advance notice should behave in the discussion which follows.

A new advance notice scheme: conditional advance notices

Introduction

4.31 Advance notices were designed to protect the priority of deeds due for imminent delivery in implement of a contractual obligation. In this Chapter of the Discussion Paper, our concern is with deeds which will become due for delivery months or years after an obligation has been agreed, typically only if certain conditions are fulfilled. In the following paragraphs, we consider the introduction of a new advance notice scheme designed to cover future and conditional deeds of this kind.

4.32 The starting point for development of this new mechanism is the existing advance notice scheme. Our understanding is that this system is used in the overwhelming majority of conveyancing transactions and is considered to work well. There are obvious benefits to be obtained from building on a scheme that is both successful and familiar to practitioners. In the discussion which follows, we therefore use the advance notice scheme as a template, and consider the modifications to that scheme which would be required for a new advance notice system. We seek the views of consultees throughout.

4.33 In the paragraphs which follow, we refer to this new form of notice as a conditional advance notice. We think it is useful to have a name which distinguishes the new form of notice from the existing scheme, since the effects will not be identical. Names such as "extended advance notice" or "long advance notice" seem inapposite for this reason. The term "conditional advance notice" is also imperfect, since not all obligations protected by this new form of notice will necessarily be subject to conditions. However, it seems likely that most will, and the name provides a useful shorthand while making clear the distinction. We would be grateful for the views of consultees on this issue.

4.34 We ask:

6. If a new form of notice is introduced to protect the priority of obligations to transfer land or grant a subordinate real right, should this be known as a conditional advance notice? If not, what name should be used?

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[36] The accessoriness principle is discussed in DP1 para 3.21 to 3.27. See also A J M Steven, "Accessoriness and Security over Land" (2009) 13 Edin LR 387.
[37] G Dannemann and R Schulze (eds), *German Civil Code: Article-by-Article Commentary* (2020) 1730.

Content of a conditional advance notice

4.35 The key content of an advance notice is provided for in section 59 of the 2012 Act. The notice must:

- State that a person intends to grant a deed to another person;
- State the name and designation of each person;
- Describe the nature of the intended deed (for example, whether it is to be a disposition);
- State the number of the title sheet to which the deed is to relate, or otherwise identify the property if there is no relevant title sheet.[38]

4.36 Our provisional view is that the content of a conditional advance notice would be substantially the same. The information captured provides a precise picture of the deed to be protected by the notice, and that same information is required whether the notice is conditional or otherwise. Where the obligation is subject to conditions, a gloss may need to be put on the initial statement of the person's intention to grant a deed to reflect the conditionality of this intention.

4.37 We would suggest one addition to the contents listed above, namely identification of the contract or undertaking in which the obligation to grant the intended deed is set out. This information could be captured in short form, for example "Contract between Party A and Party B concluded on X date." Identification of the source of the obligation will be important particularly if the claim to performance of the obligation is assigned and the notice assigned with it.[39]

4.38 It should be noted that the conditional advance notice scheme will provide protection in relation to the obligation to grant a subordinate real right only where that obligation is implemented by way of a registrable deed. Leases shorter than 20 years in duration are not registrable,[40] and so an obligation to grant a shorter lease could not be protected under this scheme. We do not understand that standard securities are typically taken in relation to such obligations in practice, however. We note that the issue of the appropriate duration for a registrable lease is likely to be considered in a later phase of our current project on Aspects of Leases.[41]

4.39 We would be grateful for the views of consultees. We ask:

7. If a conditional advance notice scheme is introduced:

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[38] Specific provision is made to cover deeds related to registered leases without their own title sheet, deeds related to part only of an existing property, and deeds related to as yet unregistered leases or plots of land. There is an exception to the requirement to describe part of a plot of land where the deed in question relates to a flat.
[39] See paras 4.81-4.83 below.
[40] 2012 Act s 49 provides that a deed is registrable only in so far as its registration is authorised by any enactment. Registration of Leases (Scotland) Act 1857 s 17 provides for registration of leases exceeding twenty years. No such enactment provides for registration of shorter leases.
[41] See Scottish Law Commission, Eleventh Programme of Law Reform (Scot Law Com No 264, 2023) available at: https://www.scotlawcom.gov.uk/files/1816/8552/2957/Eleventh_Programme_of_Law_Reform_2023_-_2027.pdf.

(a) Should the conditional advance notice include the same content as the advance notice?

(b) Should the conditional advance notice also include identification of the contract or undertaking in which the obligation to grant the intended deed is set out?

(c) Should any further information be included in the conditional advance notice?

Who may apply for a conditional advance notice to be entered on the Register?

4.40 Under section 57(1) and (2) of the 2012 Act, a person may apply for an advance notice if (a) they may validly grant the intended deed, or (b) the person with power to grant the deed has consented to the application for the notice. Category (a) is straightforward: the person falling within this category will generally be the owner of the land in question, and their entitlement to apply for the notice seems obvious.[42]

4.41 Category (b) requires more explanation. A person falling within category (b) must have an intention to grant a deed relating to the property despite having no power to do so at the time the notice is entered on the Register. This provision was designed to address the situation where the grantee of a deed in a transaction intends to grant a further deed immediately on registration of the first deed.[43] Typically, the grantee in this case will be a purchaser who, on registration of the disposition, is bound to grant a standard security to the lender who provided the purchase finance. With the seller's consent, the purchaser can accordingly offer the protection of an advance notice to the lender.

4.42 Any conditional advance notice scheme must allow for an application to be made by a person falling within category (a). The position in relation to category (b) is, however, less clear. A category (b) application, in the context of a conditional advance notice, would seek to protect the priority of a deed that the option holder has undertaken to deliver to a third party if and when the option is exercised. We think there are arguments in policy and in practice against allowing for obligations of this kind to be protected within a conditional advance notice scheme.

4.43 In policy terms, we discussed above the general principle within Scots property law of limiting the number of interests that can be recognised in land to facilitate productive use and avoid sterilisation. The introduction of a conditional advance notice scheme creates a new type of interest in land. Although the notice would not affect the legal capacity of an owner to dispose or otherwise deal with the land, in practice it is unlikely that any person will be willing to deal with the owner unless the party protected by the notice consents to its discharge. The effect of conditional advance notices on the land market could therefore be significant. It seems appropriate to approach the introduction of such a measure cautiously, to give time for its impacts to be understood. Limiting the categories of person who may apply for a conditional advance notice is consistent with this cautious approach. Restricting the protections of

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[42] In practice, the application is usually made by the owner's agent.

[43] Stewart, "A new era in conveyancing" (n20 above) at 153 queries how successfully the legislation as drafted reflects this intention, although it is clear the Keeper accepts the interpretation set out above: see Registers of Scotland Knowledge Base, *Advance Notices: Who Can Apply* available at https://kb.ros.gov.uk/land-and-property-registration/pre-registration/advance-notices#who-can.

conditional advance notices to persons who have contracted directly with the owner strikes us as a providing a clear and sensible limit. Persons one step removed from the owner – who have contracted with an option holder, for example – have a weaker connection to the land and less claim to interfere in its use or circulation.

4.44 Limiting the use of conditional advance notices in this way also seems roughly in line with the approach taken in current practice. We know that it is increasingly common for the holder of an option or similar interest to seek a standard security in respect of that obligation. We also understand that it is not unknown in practice for option holders, for example, to enter further conditional contractual arrangements with third parties which depend on the exercise of the option. We do not understand, however, that security over the land[44] is generally sought in respect of that further conditional obligation.[45] Allowing for category (b) applications in a conditional advance notice scheme would therefore seem to be providing a "solution" for a problem which does not, at present, exist.

4.45 Our provisional view is accordingly that a conditional advance notice scheme should allow for application for a notice to be made only by a person who may validly grant the intended deed.[46] However, we would be grateful for the views of consultees.

4.46 We ask:

8. If a conditional advance notice scheme is introduced:

(a) Should it be possible for an application for a conditional advance notice to be made by the person with the power to validly grant the intended deed?

(b) Should it be possible for an application for a conditional advance notice to be made by any other person? If so, which person and why?

Location of a conditional advance notice in the Register

4.47 An application for an advance notice is possible whether the intended deed relates to a property in the Land Register or the Register of Sasines. A notice in relation to a Land Register property is not entered anywhere on that property's title sheet. Instead, the notice is found in the application record.[47] Reid and Gretton explain that this is because, "dying after 35 days, advance notices are too short-lived to merit inclusion in the title sheet."[48] The application record, as with all parts of the Land Register,[49] is public and an advance notice is accordingly

[44] An option holder obviously cannot grant a standard security over (ownership of) the land in relation to which the option is held. However, if the owner has granted a standard security to the option holder in respect of the option, a sub-security arrangement could in principle be entered into. This would entail the option holder granting a standard security over the original standard security in respect of any obligation conditional on the exercise of the option. We do not understand sub-security arrangements of this kind to be common in this context in practice.

[45] Other forms of security may be sought, of course.

[46] As under the current advance notice scheme, an application could be made on this person's behalf by an agent in line with the general law of agency.

[47] 2012 Act s 57(4)(a)(i). Where the notice relates to a proposed split-off deed, the Keeper must delineate the boundaries of the new property on the cadastral map: s 57(4)(a)(ii). The operation of the Land Register would require the same to be true in relation to conditional advance notices.

[48] Reid and Gretton, *Land Registration* para 10.5.

[49] 2012 Act s 2(d) provides that the application record is part of the Land Register.

discoverable by a person searching the Register. Once the 35-day protected period has elapsed, the notice is moved directly from the application record to the archive record.[50]

4.48 This system appears to operate well in the time-limited context of the advance notice system. However, since a conditional advance notice will be in place for a far longer period, an argument may be made for its inclusion on the title sheet of the relevant property. One strength of the land registration system is that the title sheet provides most of the key information related to a property in a relatively straightforward manner, comprehensible even to a non-expert.[51] The existence of a conditional advance notice seems as likely to be relevant to a person intending to deal with a property as a standard security, real burden or servitude. The application record, which is inherently transient in nature, may also seem a poor fit for a matter of longer-term interest in relation to a particular property.

4.49 If consultees support the entry of a conditional advance notice in the title sheet, the question arises of which section of the title sheet would be most appropriate for this purpose. Arguments may be made in favour of three of the four sections.[52]

4.50 Above, we considered the conceptualisation of a conditional advance notice as a form of *sui generis* security right. Whether or not this conceptualisation is correct, a person seeking to transact with a registered property is likely, in practice, to treat a conditional advance notice as they do a standard security, requiring its discharge for the transaction to proceed. Entering a conditional advance notice in the securities section of the title sheet may therefore be a sensible option from a practical perspective.

4.51 An alternative may be to enter a conditional advance notice in the burdens section. The notice could be understood to operate as a form of encumbrance on the title, since the priority accorded to the protected deed continues regardless of whether ownership of the property changes hands during the protected period. In the German land register, which has one section for encumbrances on the title such as title conditions[53] and a separate section for securities,[54] *Vormerkungen* are entered in the encumbrances section. From a practical perspective, however, a conditional advance notice is unlikely to be treated in the same manner as other entries in the burdens section during a conveyancing transaction. Generally, entries in the burdens section simply are expected to be borne by a new owner. A conditional advance notice, on the other hand, could result in eventual loss of ownership, hence the suggestion above that the discharge of such a notice is likely to be prerequisite to the conclusion of a transaction. Moreover, the burdens section of a title is usually the most difficult to navigate,[55] arguably increasing the risk that a conditional advance notice may be overlooked if entered here.

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[50] 2012 Act ss 62(1) and 63(4)(a).
[51] We agree here with the opinion expressed in Reid and Gretton, *Land Registration* para 3.2. We also agree with their comment in footnote 5 of the same paragraph: "Non-experts – and indeed sometimes experts too – will often be baffled by the D (burdens) section."
[52] 2012 Act s 5 provides that a title sheet will be made up of a property section, a proprietorship section, a securities section and a burdens section. More detail on each section can be found in Reid and Gretton, *Land Registration* 61-66.
[53] *Abteilung II*: GBV para 10.
[54] *Abteilung III*: GBV para 11.
[55] Reid and Gretton, *Land Registration* para 3.2.

4.52 Finally, we note that in the land registration system of England and Wales, any restriction is entered in the proprietorship register.[56] This is logical bearing in mind the restriction effectively limits the registrability of deeds the owner would otherwise have the power to grant.[57] Since this would not be the effect of a conditional advance notice, the case for its entry in the proprietorship section of the Land Register seems weak. We mention it here for completeness, however.

4.53 Where the property to which the intended deed relates is still in the Register of Sasines, an advance notice simply enters the Register of Sasines.[58] There would seem no reason to take an alternative approach in relation to conditional advance notices.

4.54 We ask:

9. If a conditional advance notice scheme is introduced:

(a) Where the intended deed relates to a property in the Land Register, should a conditional advance notice be entered on the title sheet of that property?

(b) If so, in which section of the title sheet should it be noted?

(c) If not, where in the Land Register should the conditional advance notice be located?

(d) Where the intended deed relates to a property in the Register of Sasines, should a conditional advance notice be recorded in that Register?

Length of the "protected period" for a conditional advance notice

4.55 An advance notice has effect for a period of 35 days beginning with the day after the notice is entered in the application record (or recorded in the Register of Sasines).[59] Of course, for a conditional advance notice scheme to achieve the objective behind its introduction, such notices would have to be effective for a substantially longer period, measured in years rather than days or months.

4.56 Identifying an appropriate protected period for conditional advance notices is difficult. The contractual agreements which give rise to applications for these notices will vary significantly in their terms and the nature of the conditions to be fulfilled. There will be no standard period of time within which delivery of the protected deed would normally be expected. Despite this, we think there would be value in providing for a fixed protected period rather than allowing for conditional advance notices to remain in place indefinitely.

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[56] Land Registration Rules 2003 r 8.
[57] Land Registration Act 2002 ss 23-24 and 40.
[58] 2012 Act s 57(4)(b).
[59] 2012 Act s 58(1).

4.57 Our concern here is to ensure there is a point after which such notices can safely be deleted from the Register.[60] Our property law projects over the past 30 years have repeatedly dealt with the difficulties of removing unenforceable and/or expired rights from the Register.[61] The presence of "dead" rights on the face of the Register complicates matters for the owner and parties wishing to deal with properties ostensibly affected by such rights, with consequences for the complexity and cost of conveyancing transactions. The presence of "dead" rights also makes the Register less accurate and more difficult to navigate, counter to government policy ambitions concerning transparency of land ownership.[62] Providing for a fixed protected period will avoid these difficulties in relation to conditional advance notices. It also does not appear to us to impinge unduly on the protection provided, bearing in mind that (unlike servitudes and real burdens, for example) the notice is by definition intended to be a temporary measure.

4.58 An approach which strikes an appropriate balance between the competing concerns expressed above may be to provide for a fixed protected period, whilst allowing for an extension of the notice at the conclusion of that period. The effect would be to extend the protected period for a further fixed duration. The current advance notice scheme makes no provision for extension of the notice.[63] This was excluded on policy grounds, not least the fact that the notice provides the protected deed with priority over involuntary competing deeds registered against the owner, as discussed further below.[64] Below, we set out our provisional view that a conditional advance notice should provide a more limited form of protection than an advance notice under the current scheme, so that the intended deed will not be protected against interests imposed on the owner. If that view is accepted by consultees, along with our view that only the owner of land should be entitled to apply for a conditional advance notice, we think the policy concerns that excluded extension of advance notices are addressed sufficiently to allow for extension of conditional advance notices.

4.59 As with the initial entry of the conditional advance notice onto the Register, extension of a conditional advance notice should normally be entered onto the Register by the person intending to grant the deed. However, we think it should also be possible for an extension to be entered by the person to whom it is intended the protected deed will be granted. The period of protection provided for in statute is fixed as an administrative convenience, to prevent the accumulation of obsolete notices on the Register. It does not seem appropriate to allow it to operate as a guillotine, terminating protection which continues to be required, simply because the person intending to grant the deed cannot or will not effect an extension. If there is a dispute as to whether the protection does continue to be required, the party who believes the notice should be removed from the Register should seek a discharge, supported by a court decree if necessary. We discuss the discharge provisions further below.

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[60] More precisely, the concern is with removing conditional advance notices from the title sheet record. We would expect that an expired conditional advance notice, as with an expired advance notice, will then form part of the archive record: 2012 Act s 62.

[61] See, for example, the extensive mechanisms proposed to allow for variation and termination of real burdens in our Report on Real Burdens, and the discussion of a potential sunset rule for standard securities in this project (DP1 paras 11.50-11.52).

[62] Scottish Government, *2022 Land Rights and Responsibilities Statement* (2022), Principle 6.

[63] Reid and Gretton, *Land Registration* para 10.16. If the intended deed is not registered during the protected period, it would be possible to apply for a second advance notice, but this will provide no priority over competing deeds registered during the period covered by the initial advance notice.

[64] See paras 4.62-4.64.

4.60 Allowing for extension of the notice will provide an important element of flexibility to deal with the range of contractual arrangements underlying notice applications. Nevertheless, to minimise the administrative burden on parties and the Keeper, the length of the protected period would ideally be sufficient to cover the lifetime of a substantial number of such arrangements without the need for an extension application. We noted above that an inhibition remains in place for five years.[65] Advisory group members have suggested to us that five years may be an appropriate duration for a conditional advance notice also. We would be grateful to hear further from consultees on this issue.

4.61 We ask:

10. If a conditional advance notice scheme is introduced:

(a) What should be the duration of the protected period and why?

(b) At the end of the protected period, should it be possible to extend the period by the same fixed duration? If not, why not?

(c) Should it be possible for the person intending to grant the deed to extend the period of the notice? Should it also be possible for the intended grantee of the deed to extend the period of the notice? If not, why not?

Effect of a conditional advance notice: protection against competing deeds

4.62 We explained above that an advance notice has two main effects.[66] First, it protects the priority of the deed specified in the notice against competing deeds registered during the protected period.[67] This protection operates according to the principle of "non-opposability". The protection applies to all deeds, voluntary and involuntary,[68] subject to two specific exceptions: notices registered under section 10(2A) of the Title Conditions (Scotland) Act 2003 or section 12(3) of the Tenements (Scotland) Act 2004.[69] The effect of these excepted notices is that an acquirer takes on outstanding liabilities of the former owner in relation to shared maintenance obligations imposed by a real burden or under the 2004 Act.

4.63 The second effect of an advance notice is protection against inhibitions. Where the protected deed is registered during the protected period, it is not subject to an inhibition registered earlier in the protected period or any entry in the Register of Inhibitions earlier in the protected period which takes effect as if an inhibition.[70] The primary example of an entry falling into the latter category is a notice following grant of a warrant on a sequestration petition.[71] Accordingly, the advance notice provides a certain level of protection against insolvency, particularly where the granter of the protected deed may be sequestrated.[72]

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[65] Conveyancing (Scotland) Act 1924 s 44(3)(aa).
[66] See paras 4.24-4.27 above.
[67] 2012 Act s 59 (Land Register) and s 60 (Register of Sasines).
[68] 2012 Act s 61(2).
[69] 2012 Act s 61(3).
[70] 2012 Act s 61(1).
[71] Bankruptcy and Diligence (Scotland) Act 2016 s 26.
[72] The advance notice does not provide protection in relation to corporate insolvency processes.

4.64 We explained above that the advance notice scheme was designed as a replacement for the older system of letters of obligation. The intention was to protect against two risks arising during the period between conclusion of missives and registration of a disposition: first, the risk that a competing deed might be granted, and second, that the granter might become insolvent. The first risk is addressed by the advance notice providing priority over voluntary deeds. The second risk is addressed by the priority over involuntary deeds and the protection against inhibitions. Whether each of the same risks should or can be covered by a conditional advance notice is not a straightforward question. We consider each risk in turn.

Priority over voluntary competing deeds

4.65 The focus in this Chapter has been on how to protect obligations to transfer land or grant a subordinate real right against voluntary competing deeds granted by the land owner. This is the risk against which a standard security is principally taken at present, and in respect of which reduction of the competing deed under the offside goals rule provides a remedy. In that respect, there seems no difficulty with concluding that a conditional advance notice scheme must also provide priority over voluntary competing deeds during the protected period.

4.66 As we explained above, an advance notice protects the priority of the deed specified in the notice according to the principle of non-opposability. The same approach is taken to the *Vormerkung*, which we noted above is available in relation to future and conditional obligations. This principle appears to us to provide a solution relatively close to the principle of the offside goals rule, and also to have the benefit of familiarity from the advance notice system itself. Our provisional view is that this is the approach which should be adopted for conditional advance notices.

4.67 The effect, as explained above,[73] will depend on the deeds in question. If the conditional advance notice protects an intended disposition and a competing standard security is granted during the protected period, the effect is that the security will become invalid from the point at which the disposition is registered. If both protected and competing deeds are dispositions, again the competing deed will become invalid at the point at which the protected deed is registered.[74] The Keeper will alter the Register to reflect changes which result from registration of protected deeds where appropriate,[75] for example by noting that the protected security ranks prior to the competing security as the result of a conditional advance notice, or by deleting the name of the grantee of the competing disposition from the proprietorship section and entering the name of the grantee of the protected disposition.

4.68 In theory, multiple competing deeds could be registered during the long protected period envisaged for conditional advance notices, which could make the consequences of registration of the protected deed more complex. This risk seems very unlikely to materialise, however, since in practice it is unlikely that any person will deal with land subject to a conditional advance notice without discharge of the notice or consent from the notice holder. We do not understand that any such difficulty has arisen in practice in relation to the *Vormerkung*, which operates according to the same principle, as we noted above.

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[73] See para 4.24-4.27.
[74] More detailed examples can be found in Reid and Gretton, *Land Registration* para 10.22 and Registers of Scotland Knowledge Base, *Advance Notices: How It Works* available at https://kb.ros.gov.uk/land-and-property-registration/pre-registration/advance-notices#how-it-works.
[75] 2012 Act s 59(2).

4.69 A separate challenge may arise where a competing deed is registered prior to the point at which the obligation to grant the protected deed becomes enforceable. This could occur where specific conditions, such as the passing of a period of time or the grant of planning permission, must be fulfilled before the deed is due for delivery. Registration of a competing deed may make fulfilment of the conditions less likely or even impossible. The protected deed might therefore never be granted. In these circumstances, the protection the conditional advance notice system is intended to provide against competing deeds could be circumvented *by* a competing deed.

4.70 Again, we think this risk is unlikely to materialise for the practical reasons we outlined previously.[76] Given the significance of its potential consequences, however, we think this risk should be addressed. In the German system, the *Vormerkung* protects performance of the obligation to grant the protected deed, in addition to the deed itself.[77] In this context, the effect of the non-opposability principle is that registration of a competing deed is ineffective to the extent that it would defeat or adversely affect performance of the protected claim. The beneficiary of the notice can therefore require deletion of the competing deed from the land register where it is necessary to realise performance of the protected obligation.[78] In Scots law terms, the effect would be that a competing deed could be reduced at the instance of the beneficiary of the conditional advance notice. This would be possible where the competing deed would defeat or adversely affect the performance of the obligation to grant the protected deed, even where that obligation is not yet enforceable.

4.71 This protection may be greater than that currently provided under the offside goals rule. It is not clear whether the rule applies to unexercised options, and no case directly in point has been reported.[79] However, the approach taken in current practice assumes the offside goals rule to apply in this situation. Mirroring this assumption within the conditional advance notice scheme seems therefore to accord with the cautious approach to reform we consider appropriate here. In addition, policy arguments favour the protection of pre-exercise options within the scheme. Granting a competing deed subsequent to grant of an option will almost invariably involve breaching that option. The conditional advance notice will alert the grantee of the competing deed to the existence of the breach. It is difficult to argue that the right of the grantee should be preferred to that of the notice holder in these circumstances.

4.72 In short, our provisional view is that both the protected deed, and performance of the obligation to deliver the protected deed, should be protected against the grant of competing deeds on the basis of the non-opposability principle.

4.73 For completeness, we note that an alternative approach would be possible based on the restriction available in the land registration law of England and Wales.[80] The effect of a

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[76] See para 4.68.
[77] BGB § 883.
[78] BGB § 888.
[79] Lord Emslie indicates that he would have found an unexercised option to fall within the ambit of the offside goals rule in *Gibson v Royal Bank of Scotland* [2009] CSOH 14 at [50]. Lord Drummond Young takes a more ambivalent position in *Advice Centre for Mortgages v McNicoll* 2006 SLT 591 at [51]. For discussion, see A Steven, "Options to purchase and successor landlords" (2006) 10(3) Edinburgh Law Review 432-437; R G Anderson and J MacLeod, "Offside goals and interfering with play" (2009) (17) Scots Law Times 93-97; P Webster, "*Gibson v Royal Bank of Scotland plc*: Options for the offside goals rule" (2009) 13(3) Edinburgh Law Review 524-528; P Webster, *Leasehold Conditions* (2022) paras 9-20 to 9-32.
[80] Land Registration Act 2002 ss 40-47. For an overview, see S Bridge, E Cooke and M Dixon, *Megarry and Wade: The Law of Real Property* (9th edn, 2019) paras 6-077 to 6-084.

restriction is to regulate the circumstances in which a disposition can be registered in relation to the estate in question. In short, registration will only be possible where the disposition conforms to the terms of the restriction.[81] We do not think this approach would transplant successfully into the Scottish system. First, the use of this mechanism for protection of contractual obligations is not uncontroversial in England and Wales and may be subject to reform.[82] Secondly, it requires HM Land Registry staff to take a view on whether a disposition presented for registration conforms to the restriction.[83] Placing a similar burden on Registers of Scotland staff seems undesirable in practice and in principle. Thirdly, restricting the power of an owner to grant a disposition capable of registration is a larger incursion into an owner's rights than an advance notice. This is arguably inconsistent with the cautious approach we advocate above. Overall, adopting an approach of this kind in Scotland seems unwise.

4.74 We ask:

11. If a conditional advance notice scheme is introduced:

(a) Should the priority of the deed specified in the notice be protected against any voluntary competing deed registered during the protected period? If not, why not?

(b) Should performance of the obligation to deliver the deed specified in the notice be protected against any voluntary competing deed registered during the protected period? If not, why not?

Protection against involuntary competing deeds and inhibitions

4.75 The second protection provided by the current advance notice scheme is priority against involuntary competing deeds and inhibitions, which includes protection where the granter of the protected deed is sequestrated.[84] Deciding whether this protection should also be provided by a conditional advance notice is not straightforward, since there is no equivalent in current practice to map onto. Where a standard security has been granted in respect of an option, it provides protection against a subsequent insolvency process in a financial sense through the rules of ranking: a prior secured debt must be paid in full before any claim can be made on the property by lower ranked creditors. However, if the secured option holder seeks performance of the obligation to transfer, rather than damages for its breach, it is not clear what effect the security will have.

4.76 For example, section 109(7) of the Bankruptcy (Scotland) Act 2016 provides that a trustee in sequestration may not sell heritable property subject to a prior security without the concurrence of the security holder unless the trustee obtains a sufficiently high price to discharge the security. If the obligation is not one that can be satisfied with money, is the effect that the property simply cannot be sold without the security holder's consent? There would seem an obvious injustice to other creditors in the insolvency, and potentially also to the insolvent owner, if the property could be held in limbo in this way by the secured option holder.

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[81] Land Registration Act 2002 s 41.
[82] See the discussion in Law Commission, Updating the Land Registration Act 2002 (Law Com No 380, 2018) paras 10.13-10.85.
[83] Disputes over restrictions amount for around 30% of the annual referrals made by Land Registry to the Land Registration Division of the First-tier Tribunal (Property Chamber): Law Commission, Updating the Land Registration Act 2002: A Consultation Paper (Law Com CP No 227, 2016) para 10.2.
[84] See para 4.63.

Perhaps the more likely possibility is that the legislation would be read to require that the security holder accept damages for breach in respect of their secured claim. But this is to speculate.

4.77 In practice, we understand that the position of a secured option holder will usually be resolved through negotiation with other creditors. If the option holder is keen to proceed with acquisition of the land, other creditors may well be happy to accept that injection of cash into the estate regardless of where or how the security ranks. A conditional advance notice scheme would do nothing to preclude such negotiations. However, a default rule is needed to ensure clarity in the law.

4.78 On balance, we think the preferable approach here may be to restrict the protection provided by a conditional advance notice to competing voluntary deeds. If the protection extended to involuntary deeds, it would become impossible to deal with the property as part of an insolvent estate, since any purported sale would be subject to eventual reduction at the hands of the option holder. This seems prejudicial to other creditors in addition to being somewhat impractical. Since it is not clear that a secured option holder has any such power under the current law, we consider the cautious approach we recommend above to counsel against conferring this power on the option holder under the conditional advance notice scheme.

4.79 Restricting the protection offered by a conditional advance notice in this way has a disadvantage, however. In current practice, a standard security provides the option holder with protection in two senses: against competing deeds under the offside goals rule, and against the insolvency of the owner in the sense of securing damages for breach. A conditional advance notice will provide an enhanced version of the first protection. It will not provide the second protection. Of course, there will be nothing to prevent the option holder continuing to take a security to cover damages for breach in the case of insolvency. The overall position would therefore still be an improvement on the current law, albeit that the outcome is less streamlined than may have been hoped.

4.80 We would be grateful for views on this difficult issue. We ask:

12. If a conditional advance notice scheme is introduced, should the priority of the deed specified in the notice be protected against:

(a) Any involuntary competing deed registered during the protected period?

(b) An inhibition, or another entry in the Register of Inhibitions which takes effect as if an inhibition, during the protected period?

Please provide reasons in support of your answers if you wish.

Transfer of a conditional advance notice

4.81 No provision is made in the 2012 Act for transfer of an advance notice. This is unsurprising given the context in which it is used and the mischief it was designed to prevent.[85]

[85] See paras 4.22 and 4.23.

However, such provision will, we think, be necessary in relation to conditional advance notices. The conditional advance notice scheme aims to protect relevant obligations contained in option agreements and similar undertakings. The creditor's rights under such agreements can be, and sometimes are, assigned in practice. There seems no reason why a notice protecting performance of the obligations should not be capable of assignation alongside them.

4.82 In this respect, it is useful to understand the conditional advance notice as a type of right in security, accessory to the obligation to transfer land or grant a subordinate real right. The basic principle that assignation of a claim carries with it accessory security rights[86] will be placed on a statutory footing by the Moveable Transactions (Scotland) Act 2023 when brought into force.[87] The Act also places a duty on the assignor to perform any act necessary to effect the assignation of the security as soon as reasonably practicable after the claim is transferred.[88] If a conditional advance notice is properly characterised as a right in security as we suggest, these provisions would seem to apply where a related claim under an option agreement or similar undertaking is assigned. However, to put the matter beyond doubt, we think it would be sensible to make explicit provision in any future legislation that the assignee of a claim protected by a conditional advance notice is entitled to a transfer of the notice itself, with the assignor required to take the necessary steps to effect the transfer.

4.83 We would suggest that the grantee of the protected deed specified in the notice should have the power to apply for transfer of the notice. Where such an application is made, the Keeper will delete the name and designation of the applicant from the notice and insert the name of the new holder. This would have no effect on the protected period, which will run from the date the notice is first entered onto the Register regardless of any transfers taking place during that period.

4.84 We ask:

13. If a conditional advance notice scheme is introduced, should it be provided that:

(a) Where the claim protected by the notice is assigned, the assignee acquires the right to the notice;

(b) The intended grantee of the protected deed has the power to apply for transfer of the notice, and must do so where necessary to transfer the notice following assignation of the protected claim?

Discharge of a conditional advance notice

4.85 An advance notice may be removed from the Register by the Keeper at the expiry of the protected period, or as the result of an application for discharge of the notice by the person who applied for it. We suggested above that a conditional advance notice should also be removed at the expiry of the protected period. Here, we consider how the discharge provisions might apply to a conditional advance notice.

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[86] Stair, *Institutions* III.1.17; Erskine, *Institute* III.5.8; Bankton, *Institute* II.191.7.
[87] Moveable Transactions (Scotland) Act 2023 s 15(2).
[88] Moveable Transactions (Scotland) Act 2023 s 15(3).

4.86 During the protected period, the person who applied for the advance notice may apply to the Keeper for discharge of the notice.[89] The Keeper will accept the discharge application if the person to whom the intended deed would be granted consents and the relevant fee is paid.[90] If the discharge application is accepted, the Keeper must remove the advance notice from the application record,[91] at which time it ceases to have effect.[92]

4.87 If a conditional advance notice system is introduced, a discharge process will be necessary. A similar approach could be taken. An application for discharge could be made by the person who applied for the notice. If the application was accepted by the Keeper, she would be required to remove the notice from the Register, and it would cease to have effect.

4.88 The consent of the intended recipient of the deed to the discharge would continue to be required, but bearing in mind the length of time for which a conditional advance notice is likely to be in place, some additional provision may be required in this respect. Under the current scheme, the applicant simply certifies that the intended grantee would so consent. Reid and Gretton note that this gives rise to "a risk, no doubt small"[93] of a fraudulent discharge, particularly since the offence that would be committed when providing false or misleading information in relation to an application for registration does not apply to an application for discharge.[94] The lengthy period during which the conditional advance notice will be in place might increase the risk of fraud here, not least because the intended recipient is less likely to be paying regular attention to the state of the Register than in the case of a standard advance notice where the transaction is highly active during the protected period. The obvious solution would seem to be to require written consent by the intended recipient to an application for discharge of a conditional advance notice, rather than leaving it to the applicant to certify.

4.89 Requiring written consent to a discharge from the intended recipient, in addition to the length of the protected period under a conditional advance notice, gives rise to some potential difficulties, however. The intended recipient may die or be dissolved (if a juristic person), leaving the land owner unsure of the person from whom consent might now be required. Alternatively, the intended recipient may become impossible to trace or simply fail to respond. Since the protected period is of fixed duration, this problem will not continue indefinitely. However, the inability to discharge the notice may leave the property unmarketable for longer than is desirable.

4.90 More problematically, the intended recipient may refuse to consent to the discharge. For example, this can occur if the parties are in dispute as to whether the obligation the notice protects remains enforceable. Since we propose that either party to the notice may apply for an extension, the passage of time may not bring matters to an end in this scenario.

4.91 The issues we describe above also arise in relation to redemption of standard securities.[95] In that context, we proposed that the relevant party should be entitled to seek a court order which, on registration, should discharge the security.[96] We think the same

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[89] 2012 Act s 63(1)-(2).
[90] 2012 Act s 63(3).
[91] 2012 Act s 63(4).
[92] 2012 Act s 63(5).
[93] Reid and Gretton, *Land Registration* 10.15.
[94] 2012 Act ss 112-113. An application for discharge of an advance notice is not "an application for registration" in the meaning of the Act.
[95] See DP1 paras 11.15-11.39.
[96] DP1 para 11.39.

approach may be useful here. The court, if satisfied that the conditional advance notice has been extinguished as the result of performance or extinction of the obligation it protects, may grant decree to that effect. An application for deletion of the notice from the Register may be made on the basis of that decree.

4.92 We seek consultees' views. We ask:

14. If a conditional advance notice scheme is introduced:

(a) Should provision be made for discharge of the notice as under the advance notice scheme, subject to the reform of the requirement of consent from the intended recipient?

(b) Should the intended recipient be required to consent to the discharge application in writing?

(c) Should a court process be available for discharge where the intended recipient cannot be found, fails to respond or refuses to consent?

Exclusion from the conditional advance notice scheme: lease options?

4.93 The conditional advance notice scheme outlined above is intended to apply generally to obligations to transfer land or grant subordinate real rights. However, a question may arise over the use of the scheme where the obligation is to transfer land to its tenant, typically on the exercise by the tenant of an option at a particular time, for example at or shortly before the end of the lease. Such obligations have distinct characteristics which may suggest they are unsuitable for protection within the conditional advance notice scheme.

4.94 First, parties to an option to purchase unconnected with a lease (referred to here as a "standalone option") generally have no relationship beyond the grant and eventual exercise of that option. Although they may interact with each other regularly during the period in which the option contract is in place, their interactions will generally revolve around fulfilment of the conditions of the option. If the option is held in the context of a landlord-tenant relationship, the option is unlikely to be a focus at all until the time for exercise of the option approaches. Second, the duration of a standalone option contract is likely to be much shorter than a contract conferring an option on a tenant. We understand that most standalone option agreements come to a conclusion in three years or less. A commercial lease might last for much longer and even for decades.

4.95 One result of these practical differences is that landlords and tenants may find the remedies available under the conditional advance notice scheme we propose above to be unattractive. Where a landowner transfers ownership in breach of a standalone option, the option holder has a clear interest in reducing that transfer. That is not necessarily the case where the option holder is a tenant in respect of the let property. It is common for landlords to transfer ownership of let premises. Absent an express term in the lease or the option agreement it is not at all clear that a tenant has an interest or even entitlement to reduce any transfer by a landlord.

4.96 For a tenant, a preferable remedy may be the ability to enforce the purchase option against singular successors of the original landlord. However, there are difficult policy

questions here. Longstanding authority[97] exists to the effect that an option is not *inter naturalia* of a lease,[98] and therefore cannot be enforced against singular successors of the landlord. This authority was reaffirmed in an Outer House decision of Lord Drummond Young in 2006.[99] The concept of *inter naturalia* terms has been criticised for having no clear basis on which to ascertain which terms it does (or should) encompass.[100] This is an issue which affects obligations beyond those to transfer land pursuant to an option. We hope to address this issue as part of our ongoing project on Aspects of Leases.[101] We do not think proposals within this project on heritable securities can or should pre-empt that work.

4.97 Generally, we consider that any obligation to transfer land should be entitled to the protection offered by our proposed conditional advance notice scheme. However, we have some concern that the use of conditional advance notices in respect of purchase options held by tenants may serve to complicate current practice rather than improve it. If so, we recognise that an argument may be made for excluding the use of conditional advance notices in relation to purchase options conferred on tenants by their landlords.

4.98 We would be grateful to hear from consultees on this issue. We ask:

15. Do you have any comments on the use of conditional advance notices in relation to purchase options held by tenants in respect of the property they lease?

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[97] *Bisset v Magistrates of Aberdeen* (1898) 1 F 87.
[98] This phrase may be approximately defined to cover terms which are of the essence of the contract of lease rather than extrinsic matters agreed between the partes: see P Webster, *Leasehold Conditions* (2022) para 3-20.
[99] *Advice Centre for Mortgages v McNicoll* 2006 SLT 591 at [37]-[40].
[100] For discussion, see P Webster, *Leasehold Conditions* (2022) para 3-14 to 3-24.
[101] See Scottish Law Commission, Eleventh Programme of Law Reform (Scot Law Com No 264, 2023) available at: https://www.scotlawcom.gov.uk/files/1816/8552/2957/Eleventh_Programme_of_Law_Reform_2023_-_2027.pdf.

Chapter 5 Alternative mechanisms for protecting obligations to transfer land

Introduction

5.1 In the previous Chapter, we set out a detailed scheme for protecting obligations to transfer land or grant subordinate real rights by way of a conditional advance notice system. We consider this system to be the best fit for the objectives of law reform in this area. However, it is not the only possible mechanism by which this type of protection could be provided.

5.2 In DP1, our treatment of secured obligations *ad facta praestanda* included brief consideration of various mechanisms by which obligations to transfer land might be protected under a reformed law.[1] In this Chapter, we give more detailed consideration to each of these mechanisms, and explain our view that they are a less appropriate choice than the conditional advance notice system set out in Chapter 4. In the discussion which follows, we focus on obligations to transfer land, but the same considerations apply in respect of obligations to grant subordinate real rights.

5.3 We consider first a potential solution within the law of standard securities, then go on to look at real burdens and inhibitions. Finally, we seek views from consultees on whether it would be appropriate to consider any of these mechanisms further in future.

Alternative provision within the law of standard securities

5.4 In Chapter 2, we outlined the conceptual difficulties where a security is granted in respect of a non-monetary obligation.[2] In short, rights in security are designed to ensure performance of monetary obligations, and the remedies they make available to the security holder are therefore directed towards realising money from the security property.[3] Rights in security do not provide remedies to ensure performance of non-monetary obligations, such as the obligation to transfer land. In DP1, we noted the possibility that the law could be reformed so that a standard security does provide such remedies in future. We recognised that reformed provision for the ranking of non-monetary standard securities would also be required should this route be taken.[4]

5.5 On its face, this option seems attractive. It offers the closest fit with existing practice and does not require the law to "reinvent the wheel". On closer consideration, however, difficulties become apparent. Legislation providing for a standard security that ensures performance of an obligation to transfer land would necessarily differ from routine standard security legislation in more respects than suggested by our brief overview in DP1. The rules as to the creation of a standard security would have to be altered to ensure the non-monetary

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[1] DP1 paras 4.66-4.86.
[2] See para 2.4 and paras 2.22-2.26 above.
[3] We discuss the remedies currently available under a standard security and consult on reform in DP2 Ch 9-14.
[4] We discuss the current rules on ranking amongst standard securities and consult on reform in DP2 Ch 3.

nature of the secured obligation was clear in relevant cases. Statutory obligations imposed on the owner of the security property to preserve its value as collateral, such as those currently embodied in the standard conditions,[5] may not appear justified on the basis of a security where the financial value of the property was not the focus. Similarly, the extent of any power given to a security holder to prohibit or vary the grant of other real rights in the security property[6] may change where that power is not justified by the need to preserve the value of the security property. The procedure for exercising a monetary security following default would require some changes for a non-monetary security – it is not clear, for example, that a calling up (or equivalent) procedure would make sense in the context of a breach of a secured obligation to transfer ownership through the grant of a disposition to a third party. Finally, the appropriate remedy or set of remedies would need to be found to meet the needs of the non-monetary creditor.

5.6 While the development of reform proposals along these lines would clearly not be impossible, the extent of the alternative provision required appears to remove much of the benefit of using existing legislation. This is particularly the case bearing in mind that the conditional advance notice system described in Chapter 4 provides similar benefits in a much simpler scheme. In addition to these pragmatic concerns, an argument may be made in favour of restricting standard securities to their principal use of securing obligations to pay from the perspective of legal clarity. In essence, it may be preferable to recognise a standard security as a tool for a single purpose rather than a mechanism capable of multitasking. This is how we use other rights in security in Scots law, which allows for a degree of consistency and coherence in what can otherwise be a complex area.

5.7 For the reasons set out above, and following consultation with our advisory group, we have taken the view that it would be an inappropriate use of the Commission's limited resources to develop a detailed scheme for modification of standard securities legislation to ensure performance of obligations to transfer land. However, we seek views from consultees below.

Personal real burdens

5.8 Another potential mechanism for protection of obligations to transfer land is the personal real burden. A real burden is an obligation to undertake, or refrain from undertaking, certain activities in connection with particular land or buildings. Generally real burdens can be acquired and enforced only by the owner of a piece of land adjacent to the burdened property, or the owner of a piece of land in the same community as the burdened property.[7] However, the law recognises a limited number of "personal real burdens" (PRBs) where the holder is not required to own adjacent land. PRBs generally pursue a public interest purpose and can be held only by prescribed bodies with some connection to that public interest.[8] However, in preparation for the abolition of the feudal system, legislation also allowed superiors holding feudal rights of pre-emption or redemption to instead acquire equivalent PRBs of pre-emption

[5] 1970 Act, sched 3. We discuss these and consult on reform in DP1 Ch 7.
[6] See DP1 Ch 8 for discussion.
[7] 2003 Act, s 1(1).
[8] 2003 Act ss 38-48. For example, a "conservation burden" must be for "preserving or protecting for the benefit of the public" architectural, historical or other special characteristics of land (s 38(1)) and can be held only by certain bodies including Scottish National Heritage and the Royal Society for the Protection of Birds.

or redemption in certain circumstances.[9] It seems very few such burdens were ever acquired,[10] and that small number will since have dwindled.[11] Nevertheless, a modified version of this mechanism could be developed to protect obligations to transfer land beyond the context of feudal abolition.

5.9 This approach would require amendment of Part 3 of the Title Conditions (Scotland) Act 2003 to introduce a new type of PRB. It would become competent to create a real burden in favour of any person consisting of a right to acquire ownership of the burdened property, subject to any conditions set out in the burden as agreed between the parties. For simplicity's sake, we refer to this here as an "option burden". The legislative scheme currently applicable to PRBs would generally apply to the creation, exercise and termination of option burdens, but modifications would be required. Most obviously, the usual limitations on persons entitled to hold a PRB would not apply. Interest to enforce is generally presumed for personal real burdens,[12] and consideration would have to be given to how this rule could operate in relation to option burdens, the exercise of which would generally be conditional on the occurrence of specified events. The circumstances in which such a burden could be extinguished would also need to be considered.

5.10 There are some initial attractions to a PRB solution to protection of obligations to transfer land. As with our discussion of a modified law of standard securities above, this approach would build on an existing body of law with which practitioners have some degree of familiarity. It is also competent under the current law for a real burden consisting of a right of pre-emption[13] to be held by an owner of adjacent land,[14] and the progression from a (praedial) burden of first refusal to a (personal) burden to exercise an option may seem logical.

5.11 On closer consideration, however, we think this mechanism is a poor fit for protection of obligations to transfer land. Again, there are difficulties of both practice and policy. In practical terms, the ability to build on an existing body of law may be of limited use. Real burdens are designed to regulate the use made of land, usually on an ongoing basis. Over centuries, case law has developed to set the parameters of the extent to which such burdens can be validly constituted without, for example, being repugnant to the nature of ownership.[15] To date, these rules have been little concerned with the transfer of land and the circumstances in which that power can validly be curtailed. In that respect, much of the existing law is simply irrelevant.

5.12 In policy terms, it is worth revisiting the consideration we gave to the use of real burdens in relation to rights to acquire land in our Report on Real Burdens. Our principal

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[9] Abolition of Feudal Tenure etc. (Scotland) Act 2000 s 18A. Where a feudal superior held a pre-emption or redemption burden by virtue of their superiority, it was possible for them to convert that burden into a personal real burden by registration of a notice prior to 28th November 2004. This was the "appointed day" on which the feudal system came to an end, meaning (amongst other things) that superiorities ceased to exist.

[10] K G C Reid and G L Gretton, *Conveyancing 2004* (2005) 95 reports that 642 such notices were registered in total.

[11] Notably, any redemption burden created post-1974 expires after 20 years, meaning that any subsisting burden in this category will be terminated on 28th November 2024: Land Tenure Reform (Scotland) Act 1974 s 12.

[12] 2003 Act s 47.

[13] Para 35 of the explanatory notes to the 2003 Act describe this as "a right which entitles the holder to first refusal in the event that the burdened property comes up for sale." It is not possible to create a real burden consisting of a right of reversion (which entitles the holder, as a former owner of the burdened property, to reacquire ownership on the occurrence of a specified event) or any other type of option to acquire land: 2003 Act, s 3(5).

[14] 2003 Act, s 3(5).

[15] See generally Reid, *Property* para 391.

concern there was with feudal options held by superiors in respect of the *dominium utile* of the land in question. We took the view that pre-emptions could be useful without being oppressive to the burdened owner, since they were generally not exercisable unless and until the owner had chosen to sell and would generally result in the owner receiving market value for the land.[16] In relation to options which could be triggered other than by the actions of the owner of the land, however, we were more critical:[17]

> "Options falling into this category are potentially oppressive in that the owner has no control over when, or whether, the option is to be exercised. A person may lose property without his consent and, in some cases, without adequate compensation. This is private compulsory purchase. It is one thing for an owner to agree to a redemption by contract. Then there is the initial act of consent and, sometimes, the payment of money. But it is another thing entirely for the successor of that owner to be bound. This does not seem an appropriate use of real burdens."

5.13 These observations were made in a discussion principally concerned with feudal burdens, where the risk of oppression through the exercise of a historical burden of long standing was much greater than is likely under a freely agreed, present-day option agreement. A response to our argument quoted above may be that successors consent equally to a redemption by choosing to acquire land subject to such a burden, the existence of which would presumably be reflected in the price paid. However, the broader point here appears sound: a real burden, enforceable against successive owners in perpetuity, provides a poor fit for the protection of a contractually negotiated agreement between two parties. It is worth recalling in this respect that, in current practice, obligations to transfer land are protected through reliance on the rule against offside goals. Under this rule, a transaction in breach of an obligation to transfer land may be set aside, putting the debtor back into a position to fulfil the obligation as originally intended. Reform which mirrors this effect seems to us desirable.

5.14 In addition, personal real burdens are currently available almost exclusively for the protection of public interests such as conservation. The bodies entitled to hold them may broadly be described as guardians of those public interests. Enabling this mechanism to be used for purely private interests would represent a significant policy shift. Above, we suggested a cautious approach should be adopted to the introduction of new obstacles to the transfer of land. Adapting the use of PRBs in this way seems to us insufficiently cautious.

5.15 For the reasons set out above, and following consultation with our advisory group, we have taken the view that it would be inappropriate to develop a detailed scheme for use of personal real burdens to ensure performance of obligations to transfer land. However, we seek views from consultees below.

The "personal charge": a future or conditional inhibition?

5.16 A final mechanism that could be considered is the introduction of a "personal charge". This mechanism was first mooted in the Halliday Report, which observed that Scots law had

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[16] Scottish Law Commission, Report on Real Burdens (Scot Law Com No 181, 2000) para 10.27.
[17] Scottish Law Commission, Report on Real Burdens (Scot Law Com No 181, 2000) para 10.20.

no equivalent to the floating charge for persons who are not companies. The Report continued:[18]

> "A suggestion has been made to us that a borrower might be permitted to grant a personal charge in favour of a creditor, requiring registration only in the Register of Inhibitions and Adjudications and having the same general effect as an inhibition, i.e. the granter of the charge would be precluded from disposing of his heritable property without the consent of the creditor. Such a charge would not transfer to the lender either the right to or the possession of the borrower's heritable property and it would not be a true security. It is thought, however, that a lender would be more willing to lend if he could be assured that the borrower could not deal with his heritable property without the lender's knowledge and consent."

5.17 The Report goes on to suggest that the personal charge should be available for a non-renewable period of five years, requiring registration only in the Register of Inhibitions and Adjudications, and affecting only heritable property belonging to the debtor at the time the charge was granted. The charge would take effect in the same way as an inhibition, except that the personal charge would extend to the debtor's estate on death.[19]

5.18 The focus of the Halliday Committee in proposing the personal charge was on improving access to finance for persons other than companies. However, the inhibition-like effect of the mechanism may actually be better suited to the protection of obligations to transfer land.

5.19 Inhibition is now regulated largely by sections 146-168 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. Most commonly, it is a diligence used to enforce payment of a debt,[20] and affects all heritable property in Scotland within the patrimony of the person against whom it is registered.[21] However, it may also be used to enforce an obligation to convey or grant a subordinate real right in a particular piece of heritage,[22] in which case the inhibition is limited to the property to which the obligation relates.[23] Where an inhibited person voluntarily grants a disposition or subordinate real right in property caught by the inhibition to a person other than the inhibiting creditor,[24] this breaches the inhibition.[25] The creditor may seek reduction of the transaction *ad hunc effectum*.[26] This is a relative form of reduction, meaning the transaction is reduced only insofar as necessary for the obligation owed to the inhibiting creditor to be

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[18] Halliday Report para 130.
[19] Halliday Report para 131.
[20] 2007 Act s 146(1)(a).
[21] 2007 Act s 150.
[22] 2007 Act ss 146(1)(b) and (2)(b).
[23] 2007 Act s 153.
[24] A grantee who acquires from the inhibited person in good faith and for adequate consideration receives protection under section 159 of the Bankruptcy and Diligence etc. (Scotland) Act 2007. Since the inhibition must be registered, the circumstances in which a grantee could, in good faith, be unaware of its existence are limited but not impossible: see *Commodity Solution Services Ltd v First Scottish Searching Services Ltd* 2018 SLT (Sh Ct) 117, aff'd at 2019 SLT (Sh Ct) 63.
[25] 2007 Act s 160.
[26] The literal translation of this phrase is "to this effect", but as Registers of Scotland note, it is used to mean "with limited effect": see Registers of Scotland, *2012 Act Registration Manual: Glossaries – Latin Phrases* available at https://rosdev.atlassian.net/wiki/spaces/2ARM/pages/58690453/Latin+Phrases. For discussion of the meaning of this phrase, see J MacLeod, "The Offside Goals Rule and Fraud on Creditors" in F McCarthy, J Chalmers and S Bogle (eds), *Essays in Conveyancing and Property Law in Honour of Professor Robert Rennie* (2015) 115-140 at 133-134.

fulfilled.[27] In practice, a third party will invariably refuse to deal with property subject to an inhibition without the inhibiting creditor's consent.

5.20 It is not difficult to see how, with some tweaks, inhibition could provide a mechanism for protecting future or conditional obligations to transfer land. The law already allows for a form of inhibition catching only a specific piece of heritage. At present, this form of inhibition can be registered only by a creditor holding a decree in implement of the obligation owed. The law could be amended to allow for registration in relation to a future or conditional obligation with the owner's consent. Thought might also be given to whether or how this future or conditional form of inhibition could be reflected on the Land Register, rather than solely in the Register of Inhibitions.

5.21 A mechanism along these lines seems, in our view, a better fit with property law more broadly than a bespoke form of standard security or a new form of personal real burden. The main argument against developing the idea further is, again, the existence of the advance notice system. Under current law, advance notices are a mechanism by which to protect obligations which it is expected, or at least hoped, will be performed. Inhibition, as with all diligences, is a mechanism for enforcement following a failure to perform. As the brief discussion above suggests, adaptation is possible – but it seems difficult to make the case for adaptation when a tool designed more specifically for the job in hand already exists.

5.22 For the reasons set out above, and following consultation with our advisory group, we have taken the view that it would be inappropriate to develop a detailed scheme for use of a personal charge or future and conditional inhibition to ensure performance of obligations to transfer land. However, we seek views from consultees below.

Further exploration of alternative mechanisms?

5.23 Above, we have explored three mechanisms which could potentially be used to protect obligations to transfer land or grant subordinate real rights against the grant of competing deeds by the land owner. We have explained in each case why we consider the conditional advance notice scheme outlined in Chapter 4 as a more suitable approach to achieving this objective. We would be grateful to hear from consultees whether they think there is value in exploring any of these alternative mechanisms further.

5.24 We ask:

16. Is further exploration required of the potential to protect obligations to transfer land by way of a standard security, a personal real burden or an inhibition? If so, why?

[27] For further discussion, see J G Stewart, *A Treatise on the Law of Diligence* (1898) 552 and Gretton, *Inhibition and Adjudication* 129-130.

Chapter 6 Sub-securities: development and current law

Introduction

6.1 The Conveyancing and Feudal Reform (Scotland) Act 1970 provides in section 9(2) that "it shall be competent to grant…a standard security over any land or real right in land." Standard securities are most commonly taken over (ownership of) land or buildings, or over the tenant's interest in a registered lease. However, a standard security is itself a real right in the same way as ownership or a lease. Accordingly, it is competent to take a standard security over another standard security. Such a security is sometimes referred to as a "piggyback" security", a secondary security or a sub-security.

6.2 In this Chapter, we recap the development of the law in relation to heritable sub-security arrangements and identify some situations in which secondary standard securities are put in place in practice. The summary here provides essential context for reform proposals discussed in Chapter 7. We do not pose any questions in relation to reform in this Chapter, but we do seek examples from practice of circumstances in which sub-security arrangements of this type are used.

Concept and terminology

6.3 The concept of a sub-security arrangement is not straightforward. In this section, we provide an outline in principle of how such an arrangement could be constituted, and clarify some terminology we will use in the remainder of this Discussion Paper.

6.4 A sub-security arrangement begins with an obligation by a debtor to repay a creditor. Imagine that Anna borrows money from Bob. Bob holds a claim to repayment against Anna. We refer to this as the "primary claim".[1] A claim to repayment is an item of incorporeal property which will often have a market value. It can be sold to generate funds.[2] The primary claim is now part of Bob's incorporeal property.

6.5 Bob takes a right in security from Anna in respect of the primary claim. If Anna defaults on her obligation to repay Bob, the security allows him to enforce repayment by selling the security property and applying the funds raised in satisfaction of the primary claim. The security enhances the market value of the primary claim, since it increases the likelihood that the claim will be satisfied.

6.6 In a separate arrangement, Bob borrows money from the Caledonian Bank. We refer to the Bank's claim to repayment from Bob as the "secondary claim". The Bank seeks a right in security in Bob's property in respect of the secondary claim. Bob's property includes the

[1] "Claim" is the term employed in the Moveable Transactions (Scotland) Act 2023.
[2] Not all claims to repayment can be sold or otherwise transferred: see Report on Moveable Transactions para 3.14.

secured primary claim. The Bank takes a right in security in that secured primary claim.[3] If Bob defaults on his obligation to repay the Bank, the right in security allows the Bank to enforce repayment by selling the secured primary claim and applying the funds raised in satisfaction of the secondary claim.[4]

6.7 Since the Bank's right in security is held in an existing secured claim, an arrangement of this kind may be referred to as a sub-security arrangement. We refer to the Bank's security in respect of the secondary claim as the "secondary security".

6.8 Our description above deals with rights in security as a general concept,[5] rather than looking at specific forms of security right currently available in Scots law. However, our focus in this project is on heritable securities. We turn now to sub-security arrangements involving claims secured against heritable property.

History

6.9 The concept of heritable sub-security arrangements has been little explored in Scots law.[6] The institutional writers make no mention of this type of arrangement. Gloag and Irvine do not discuss it in their treatment of heritable securities.[7] However, in their treatment of assignation of incorporeal moveables as security for debt,[8] they refer to *M'Cutcheon v M'William*,[9] a case in which a bond and disposition in security (BDS) was assigned in security for a secondary debt. A BDS is an historic form of heritable security in which the debtor disponed land to the creditor in security of the debt set out in the bond. Notwithstanding the ostensible disposition of the land in such an arrangement, it was accepted that the creditor received a subordinate real right in security and ownership of the land remained with the debtor.[10] *M'Cutcheon v M'William* concerned what was required to effect a valid assignation of the BDS, and the requirements of assignation are also the context in which the case is discussed by Gloag and Irvine.[11] The nature of the rights acquired by the assignee in security of the BDS are not discussed.

6.10 A practice of assigning in security claims secured against heritage appears to have been reasonably established by the mid-twentieth century. The fourth edition of *Burns' Conveyancing Practice,* published in 1957, includes a style for a "Bond and Assignation in Security, Constituting a Sub-Security Over A Heritable Security".[12] The style in Burns provides for the holder of a BDS to grant a bond and assignation in security of that BDS to a creditor of

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[3] In principle, this is how a sub-security arrangement would be constituted. In practice, it is not clear that it is possible to take security over a secured claim as such in Scots law, as opposed to taking an assignation in security of the primary claim in relation to which accessory security rights will follow. We discuss these difficulties in Chapter 7.

[4] The Bank's right is to sell to Bob's claim against Anna. The Bank has no right to sell Anna's property.

[5] More precisely, we are concerned here with voluntarily granted, fixed rights in security. For some discussion of the operation of a floating charge where the granter's property includes secured claims, see MacPherson, *Floating Charge* ch 9.

[6] Some discussion of "sub-pledge" can be found in Gloag and Irvine, *Rights in Security* 212-213. We consider this further at para 7.9.

[7] Gloag and Irvine suggest that, where a debtor is the holder of a heritable security, adjudication is the appropriate diligence to attach that security: *Rights in Security* 53-54. They do not consider voluntary grant of a heritable security over an existing heritable security.

[8] Gloag and Irvine, *Rights in Security* chs 13 and 14.

[9] 1876 3 R 565.

[10] We discuss the BDS in DP1 at paras 2.9-2.12.

[11] Gloag and Irvine, *Rights in Security* 472.

[12] Burns, *Conveyancing Practice* 457-458.

their own. In terms of the style, the creditor-assignee holds in security the primary claim to repayment under the bond and the powers available under the BDS to enforce payment of that claim. In the event of default on the secondary debt, the creditor-assignee has power to sell the BDS, with the sale to be regulated by statute as if it were a sale of corporeal heritable property under a security.

6.11 It is noted in Burns:[13]

> "The main objection to this form of security is, that on default in payment [of the secondary debt] it is not open to the creditor to sell the *property*.[14] All that he can do is to sell the direct security, that is, [the BDS]. The purchaser will then be a direct security-holder and in a position to sell the property if the owner makes default [in payment of the primary debt]. But this involves double procedure, delay, and expense before the property can be realised."

The text goes on to suggest that this may be avoided through the use of an alternative form of security, namely an *ex facie* absolute assignation of the BDS with a separate agreement expressing the creditor-assignee's powers. No style is provided for this form of sub-security, and nothing further is said about when and how it might be exercised.

6.12 Although the details here are limited, it does seem clear that, at this time, assignation in security was accepted as the appropriate mechanism by which to take security over a heritably secured claim. It is also worth noting that, in both sub-security arrangements referenced in Burns, the secondary security was held in the whole secured primary claim to repayment, not in the primary right in security as a separate item of property. We return to these issues in Chapter 7.

6.13 No mention is made of sub-security arrangements in the Halliday Report. However, the archival materials documenting the preparation of the Bill which became the 1970 Act include one intriguing reference in a letter between two government officials. The letter notes, with reference to the passage in Burns mentioned above, the competence of sub-securities under the law at that time. It goes on:[15]

> "It would appear that sub-securities are not expressly regulated by Statute and it is considered that this should continue to be the position in relation to sub-securities in future once the Bill has become law.
>
> So far as future sub-securities are concerned it is envisaged that they would incorporate the new form of assignation of [standard securities] and any conventional provisions the parties considered necessary to clarify that the assignation amounted only to a sub-security. The Bill as at present instructed would not prohibit such additional conventional provisions."

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[13] Burns, *Conveyancing Practice* 458.
[14] Italics in original text. "Property" here refers to the land which is disponed in the BDS.
[15] See NRS HH41/1891: Letter to G Wilson from D Cunningham dated 23rd December 1968.

6.14 The letter suggests a note in the same terms will be sent to Professor Halliday once all the officials have agreed that the position in law as stated above is correct. The archive file does not, however, contain any record of further discussion on this point.

Current law

6.15 The suggestion that assignation in security would be the appropriate mechanism for creation of a heritable sub-security arrangement did not find its way into the 1970 Act. As originally drafted, the Act provided that it was competent to grant a standard security over any "interest in land",[16] with that phrase defined to mean "any estate or interest in land…which is capable of being owned or held as a separate interest and to which a title may be recorded in the Register of Sasines."[17] The Notes on Clauses accompanying the Bill which became the Act suggest:[18]

> "The definition will include such interests as the ordinary right of proprietorship of the dominium utile of property, a right of superiority, a right to a lease which may be registered in the Register of Sasines (ie a lease for 31 years or more) and a security right itself (for example, it would be possible, as it is under the law at present, for a creditor in a heritable security to grant a heritable security to a third party over the original security in order to secure a debt which he had incurred to the third party.)"

The term "interest in land" in this section was amended to "land or real right in land" at the time of abolition of the feudal system.[19]

6.16 The policy underlying the Act was that it should no longer be possible to create a heritable security in any way other than a standard security.[20] As introduced, section 9(3) and (4) accordingly provided:

> "(3) A grant of any right over an interest in land for the purpose of securing any debt by way of a heritable security shall only be capable of being effected at law if it is embodied in a standard security.
>
> (4) Where for the purpose last-mentioned any deed which is not in the form of a standard security contains a disposition or assignation of an interest in land, it shall to that extent be void and unenforceable, and where the deed has been duly recorded the creditor in the purported security may be required, by any person having an interest, to grant any deed which may be appropriate to clear the Register of Sasines of that security."

The terminology in these subsections was also amended to replace "interest in land" with "land or real right in land" at the time of abolition of the feudal system.[21]

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[16] 1970 Act as enacted s 9(2).
[17] 1970 Act as enacted s 9(8).
[18] Notes on Clauses, clause 8 para 22.
[19] Abolition of Feudal Tenure etc. (Scotland) Act 2000 sch 12 para 30(6)(a) and (d) (amending the 1970 Act ss 9(2) and (8)). Section 9(8) was further amended by the 2003 Act sch 14 para 4(2)(b). Both subsections were amended by the 2012 Act sch 5 para 17(2) to include reference to registration in the Land Register. For discussion of the changes in terminology, see DP1 para 5.5-5.7.
[20] Halliday Report para 125.
[21] Abolition of Feudal Tenure etc. (Scotland) Act 2000 sch 12 para 30(6)(b)-(c).

6.17 In our first Discussion Paper in this project, we noted that the breadth of section 9(3) is uncertain, since it is clearly possible to create other securities in respect of land, most obviously the floating charge.[22] We suggested that the Halliday Report points to the focus of section 9(3) actually being on the three older forms of heritable security the Report specifically mentions,[23] namely the bond and disposition in security, the bond of cash credit and disposition in security and the *ex facie* absolute disposition.[24] The Notes on Clauses, and the prohibition on the creation of a heritable security by assignation in section 9(4), seem to suggest that the creation of a heritable sub-security by assignation in security was also to be prohibited by the Act. Indeed, it seems difficult to read the provisions in any other way.[25]

6.18 This view seems to be confirmed by Professor Halliday in his commentary on the Act published in 1977, where he writes simply:[26]

> "It is also possible to create a standard security over a standard security, since the creditor in the original standard security has an interest in land that is capable of being owned or held as a separate interest and to which a title may be recorded in the Register of Sasines. When the original standard security is discharged the security for the second standard security ceases to exist but it will be advisable to arrange for it to be formally discharged in order to clear the Register."

It is interesting to note, however, that in his review of Professor Halliday's commentary, Professor Noble relates an opinion from Counsel that the appropriate procedure for creation of a sub-security would be an *ex facie* absolute assignation of the standard security coupled with a back letter.[27]

6.19 Professor Halliday's commentary on the Act does not include specific consideration of how a security over a standard security might be exercised to enforce payment of the secondary claim. By the time of publication of the first edition of *Conveyancing Law and Practice* in 1987, however, difficulties here seem to have come to Professor Halliday's attention. He notes the definition of "interest in land" to include:[28]

> "A heritable security, *e.g.* another standard security, since the creditor in the original security has an interest in land which is capable of being owned or held as a separate interest to which a title may be recorded in the Register of Sasines. In practice a standard security over another standard security is undesirable because of the problems of monitoring insurance and calling-up. An assignation of the existing standard security will be preferable and avoids the need for a further standard security."

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[22] DP1 para 3.4.
[23] Halliday Report paras 102-105.
[24] DP1 para 3.5.
[25] Professor Gretton notes that the facts of *Sanderson's Trs v Ambion Scotland Ltd* 1994 SLT 645 appear to involve a purported assignation in security of a standard security, although the point was not at issue before the court: G L Gretton, "Assignation of All-Sums Standard Securities" 1994 SLT (News) 207 at 209-210.
[26] Halliday, *The Conveyancing and Feudal Reform (Scotland) Act 1970* para 6-06.
[27] I W Noble, "Review of *The Conveyancing and Feudal Reform (Scotland) Act 1970*. Second Edition. By John M Halliday. 1977. Edinburgh: W Green & Son" 1977 JR 169 at 172.
[28] J M Halliday, *Conveyancing Law and Practice* (1st edn) (1987), vol III, para 36-04. The text remains unchanged in the second edition of the book: I J S Talman (ed), *Halliday's Conveyancing Law and Practice* (2nd edn) (1997), vol II, para 51-04.

6.20 More recent commentators, as discussed in DP1,[29] accept the competence of granting a standard security over a standard security, but generally express uncertainty about how such a sub-security could be exercised within the 1970 Act regime.[30] We have not been able to find any reported case law on the issue.

Sub-securities in practice

6.21 Since publication of our first Discussion Paper in this project, we have had a number of valuable conversations with practitioners about when and how sub-security arrangements are used in practice. It seems clear that the structure is most commonly employed in complex financial transactions including securitisations and debt warehousing arrangements.

6.22 To understand this practice, it is useful to consider the structure of a basic securitisation transaction.[31] Suppose that a high street bank wishes to use its mortgage book (meaning both the bank's claims against debtors for repayment of their home loans, and the standard securities held by the bank in respect of those claims) to raise funds. A Special Purpose Vehicle (a company with the sole purpose of facilitating this funding arrangement) will be set up. The SPV will issue bonds, which are purchased by investors. The funds thus raised are paid over by the SPV to the bank. In exchange, the mortgage book is placed in a trust, with the bank as trustee and the SPV as beneficiary. The bank, now acting as a trustee, collects repayments on the loans in the normal way, then pays them over to the SPV (minus an administration fee). The SPV uses this money to make bond repayments to investors, together with additional "coupon" payments.

6.23 The investors in a securitisation arrangement will normally place their respective claims to repayment of the bonds into a trust, and provide for their interests to be collectively represented by a trustee known as the security trustee. The security trustee will seek security for the bond repayments from the SPV. Initially, this may take the form of an assignation in security of the SPV's interest as the beneficiary under the mortgage book trust. However, investors require reassurance that if the investment risk rises (which might be demonstrated, for example, by the rate of default on the home loans increasing above a certain level, or the quality of the debt contained in the mortgage book being downgraded by a ratings agency), greater security can be obtained. The securitisation contracts will impose an obligation on the bank to transfer the mortgage book to the SPV in such circumstances. In other words, rather than continuing to hold the mortgage book as a trustee, the bank will assign both its claims to repayment of the loans, and the standard securities it holds in respect of the claims, to the SPV. The securitisation contracts will then impose an obligation on the SPV to assign in security the claims to repayment of the loans to the security trustee, and to grant to the security trustee sub-securities over the standard securities. On the following page we have set out a diagram which illustrates the structure described above.

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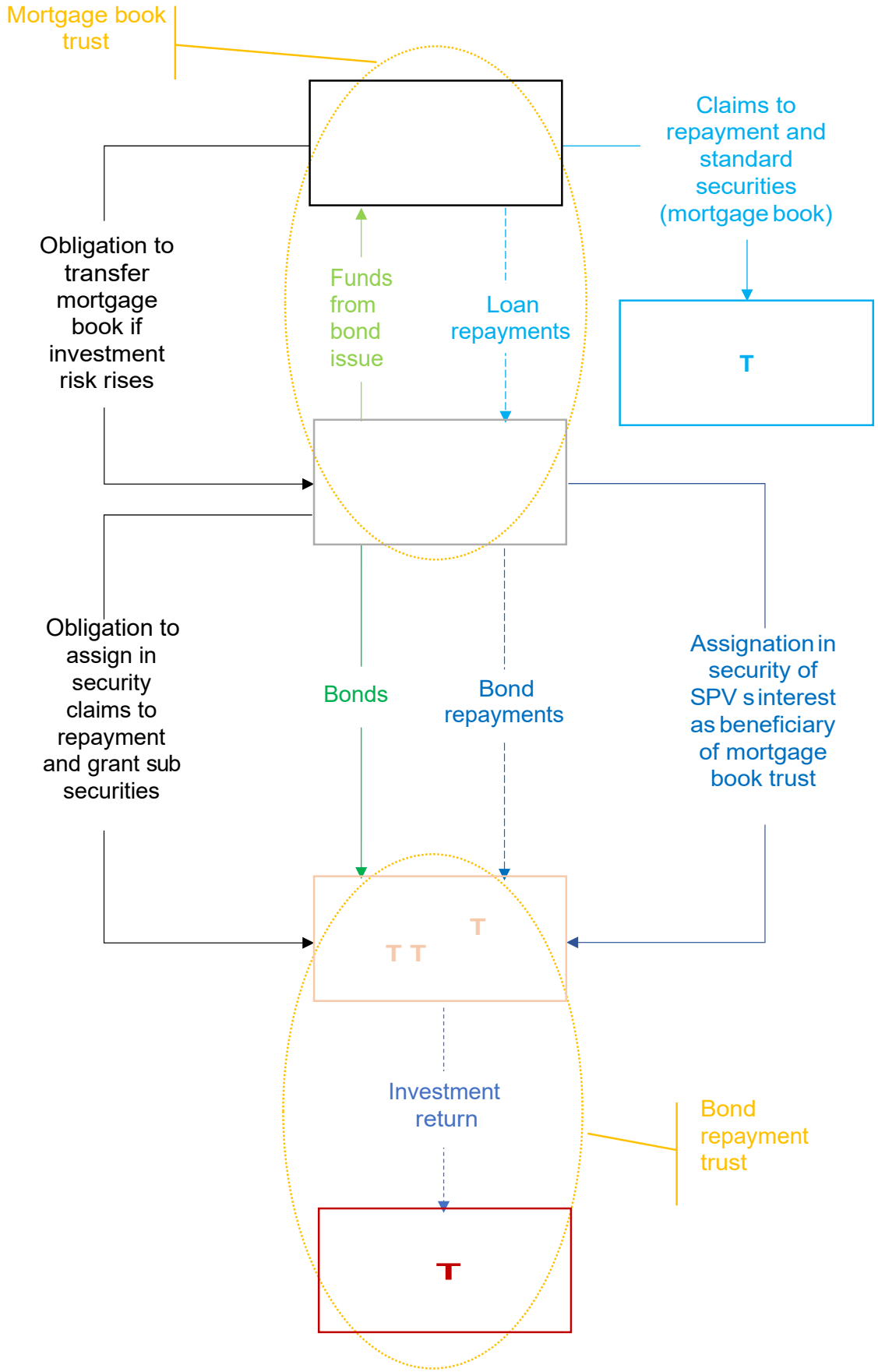
[29] DP1 para 5.26.

[30] G L Gretton, "Assignation of All-Sums Standard Securities" 1994 SLT (News) 207 at 210; C Anderson, *Property: A Guide to Scots Law* (2016) para 15-40; G L Gretton and A J M Steven, *Property, Trusts and Succession* (4th edn, 2021) para 21.45; Gordon and Wortley, *Scottish Land Law* para 20.04

[31] For a more detailed discussion of different forms of securitisation, and a comparison of how arrangements are structured under Scots law as opposed to the law of England and Wales, see T Burns, "The transfer of future rights in securitisations: a comparative study of the law in England and Scotland" (2009) 24(1) Journal of International Banking Law and Regulation 35-43. For discussion and critique of the securitisation structure, and particularly its impacts on consumer mortgage rights, in the United States, see C Odinet, "Modernizing Mortgage Law" (2021) 100 North Carolina Law Review 89.

Diagram of basic securisation structure



6.24 Our understanding from practitioners is that the circumstances triggering the performance of these "safety net" obligations arise infrequently, but that the existence of the safety net is nevertheless critical to investors, who are unlikely to invest if it is not in place. Practitioners tell us that the number of securitisation transactions taking place in Scotland on an annual basis is small. However, the value of these transactions is extremely high, sometimes in the range of tens or even hundreds of millions of pounds. We were also told that this is a growth area, and that the scope for growing it further would be increased significantly by an improved security regime. There is a sense that Scottish practitioners are losing out to their English counterparts in some cases as a result of the greater flexibility English law allows.

6.25 Securitisations and similar debt structuring transactions are not the only context in which we are aware of heritable sub-securities being used. We have also heard a small number of examples of the use of sub-securities in complex land transactions in conjunction with non-monetary obligations. In one, landowner Z entered an option agreement with Developer A. The option was secured by a standard security held in the land in question. A then entered an agreement with Builder B to assign the option in the event of planning permission being granted. B took a sub-security over A's security in order to secure A's obligation to assign. It appears that both the security and the sub-security were intended to secure their respective rights to transfer against the grant of competing deeds, as discussed in Chapter 2.[32]

6.26 In another example, landowner Z had entered an option agreement with Developer A for the purchase of land. The option was secured by a standard security held in the land in question. A then entered a promotion agreement with Promoter B, by which payments were due to B once sale of the land by A occurred. Payments due under the promotion agreement were secured by a sub-security held in A's security. The purpose of the primary security here again appears to be protection of the obligation to transfer land. How the sub-security would protect the claim to payment under the promotion agreement is less readily understandable.[33]

6.27 We are interested to learn if there are other examples of the use of sub-securities in practice. Having as full a picture as possible of the circumstances in which such arrangements are put in place will help to ensure that any future reform is appropriate. Accordingly, we ask:

17. In what circumstances is a standard security taken over a standard security in practice?

Responses to DP1

6.28 In our first Discussion Paper in this project, we noted the key difficulty with a secondary standard security arises where the holder seeks to exercise it to enforce the secondary claim. We said (footnotes omitted):[34]

> "The current battery of remedies in relation to enforcement of a standard security can hardly be regarded as suitable for standard securities over standard securities. A standard security is not marketable in the sense that a house is. And sale of the standard security on its own would be worthless because of the accessoriness

[32] See para 2.29.
[33] We did not have sight of the transaction documentation, which may have made the situation clearer.
[34] DP1 para 5.27.

principle. [The secondary security holder] also needs to be able to sell [the primary claim]. Thus an assignation in security of the [primary claim] will be needed too."

6.29 We explained that it had been suggested to us that it would be preferable to allow standard securities to be assigned in security alongside the primary claim.[35] One concern we noted in relation to this suggestion was the extent to which statute should regulate the use of a standard security assigned in security. Generally, the powers available to the holder of incorporeal property assigned in security are a matter of contractual agreement between the parties.[36]

6.30 Finally, we asked the following questions:[37]

"(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?

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

6.31 Responses revealed little consensus. Of the 18 consultees who responded to the first part of the question, seven favoured the continuing possibility of creating a standard security over a standard security, six preferred the option of allowing a standard security to be assigned in security, and the remaining five stated that they had mixed views or no strong view.

6.32 Only five consultees offered substantive comments on the question of enforcement. Of those, four suggested (at least in part) that the secondary security holder should be allowed to "step into the shoes" of the primary security holder, though it was not always clear what effect consultees thought this would have. As noted above, the secondary security holder would require to hold the primary claim for the primary security to be useful. It should also be kept in mind that a secondary security holder "stepping into the shoes" of the primary security holder would be bound by the terms of the primary debt contract. The primary security could be exercised only if the primary debtor was in default.

6.33 Our tentative view is that the key difficulty in the current law is the focus on the primary security as a security property in its own right, rather than as an accessory to the primary claim. In the Chapter which follows, we consider how this might be addressed in any new legislation.

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[35] DP1 para 5.28.
[36] We discuss this further at para 7.18.
[37] DP1 para 5.30.

Chapter 7 Sub-securities: reform options

Introduction

7.1 In this Chapter, we seek views on our provisional proposals for reform of the law in relation to security over claims secured against heritage. In short, our provisional view is that it should no longer be possible to take a standard security over a standard security. Such an arrangement is conceptually incoherent and, as a result, unworkable in practice.

7.2 The discussion then turns to whether it should be possible to assign in security a standard security. To clarify the law in this area, we suggest reliance on the general principle that accessory security rights follow the claim to repayment which they secure, with some modifications. Where a claim to repayment is assigned in security, the assignee should also have the right to acquire a standard security held in respect of that claim. Regardless of who holds it, the standard security will remain exercisable only on default in performance of the obligation which it secures.

7.3 We explain our suggested approach in more detail below, and seek the views of consultees.

Discontinuing the competence of standard securities over standard securities

7.4 The 1970 Act allows for a standard security to be taken over a standard security. Our provisional view is that this should cease to be competent under any new legislation in this area. An arrangement in which a secondary security is granted over an existing accessory right in security is conceptually incoherent. This produces the practical consequence that no effective remedies can be identified where the secondary security is exercised.

7.5 The classic definition of a right in security given by Gloag and Irvine is:[1]

> "any right which a creditor may hold for ensuring the payment or satisfaction of his debt, distinct from, and in addition to, his right of action and execution against the debtor under the latter's personal obligation."

7.6 A right in security is, in other words, a mechanism by which funds can be realised from the property in which (or the person against whom) it is held. If it is not possible to realise funds from a piece of property, it cannot provide a creditor with security. This is the difficulty inherent in a secondary standard security.

7.7 A standard security is an accessory right. Its purpose is to ensure the performance of the claim it secures. The market value of the claim is enhanced by the existence of the security, since it increases the likelihood that the claim will be satisfied. But the security has no market value independent of the claim, since it has no purpose independent of the claim.

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[1] Gloag and Irvine, *Rights in Security* 1-2.

7.8 It follows that a standard security is an unsatisfactory security property. In practical terms, it cannot be marketed for sale, since it would be of no use to a buyer except as an accessory to the secured claim. It cannot be used to generate an income through, for example, rent or royalties. It does not have a value independent of the primary claim that can be acquired, and offset against a secured obligation, through a process of compulsory acquisition such as foreclosure.[2] In short, it has no value which can be extracted in satisfaction of the claim in respect of which it is intended to serve as collateral. Accordingly, it is incoherent to use a standard security as a security property in its own right.

7.9 It is notable in this respect that there is no practice of taking a secondary security over other subordinate rights in security in Scots law. It is doubtful whether such an arrangement would be competent. Gloag and Irvine give some consideration to an arrangement they refer to as a "sub-pledge", in which the holder of a pledged item of corporeal moveable property transfers possession of that item to a third party in security of their debt to that party.[3] However, Professor Steven argues convincingly that it is not competent to grant a secondary pledge in Scots law, not least because a pledgee generally requires possession of the pledged property, and a secondary pledgee could not have possession at the same time as the primary pledgee. A pledgee transferring possession of the pledged item to a third party must therefore be understood as assigning the pledge to the third party.[4] We have found no discussion in reported case law or commentary of other sub-security arrangements.

7.10 We have also considered the position in relation to the creation of involuntary security over standard securities by way of diligence. In principle, a standard security can be adjudged by a creditor of the security holder, but the effect of this is unclear. Professor Gretton suggests:

> "On balance it is thought that [the adjudication of a standard security] does not operate as a security over the security, but rather as a redeemable assignation of the standard security, so that the adjudger is *pro tempore* [for the time being] the holder of the standard security."[5]

The new diligence of land attachment, if introduced, will not cover standard securities.[6] They were excluded on the basis that "unlike leases, there is no ordinary market for the creditor's interest in the securities."[7] Presumably it would be possible to specify standard securities as a class of property subject to the new diligence of residual attachment, if introduced.[8] However, the Policy Memorandum accompanying the Bill which became the 2007 Act makes no specific mention of standard securities in this respect, and it is not clear how residual attachment of a standard security would operate.[9]

7.11 We note for completeness that a floating charge may attach to incorporeal property in the property and undertaking of the company which granted it, which would seem to include

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[2] We discuss foreclosure in DP2 ch 14.
[3] Gloag and Irvine, *Rights in Security* 212.
[4] A Steven, *Pledge and Lien* (2008) paras 6-52 to 6-65.
[5] Gretton, *Inhibition and Adjudication* 215.
[6] 2007 Act s 82(1).
[7] Scottish Executive, *Policy Memorandum for the Bankruptcy and Diligence etc. (Scotland) Bill* (SP Bill 50-PM) (2005) para 488.
[8] 2007 Act s 129(3).
[9] 2007 Act s 130(2)(c)(i) provides that an application for a residual attachment order must state how, were a satisfaction order made, the value of the attached property would be realised. Such a statement may be difficult to make in respect of a standard security.

attachment to rights in security held by that company.[10] However, the mechanism by which a floating charge attaches to incorporeal property is a matter of debate, and to consider this process an example of a sub-security arrangement does not seem helpful here.[11]

7.12 In DP1, we noted that one practical argument in favour of allowing for a standard security to be taken over a standard security is that multiple secondary securities could be taken.[12] However, as we also noted, any additional secondary standard security would be worthless since the primary claim cannot be assigned in security more than once, so this does not seem to be a strong argument. In our conversations with practitioners on this topic since then, we have not heard of any case in which more than one secondary standard security has been granted. Accordingly, we do not think there is a strong practical argument for retaining the competence of secondary standard securities on these grounds.

7.13 Our provisional proposal is that any new legislation on standard securities should rectify the anomaly created by the 1970 Act. It should no longer be competent to grant a standard security over a standard security. We would be grateful for the views of consultees on this issue.

7.14 We ask:

18. Should the grant of a standard security over a standard security cease to be competent? If not, why not?

Assignation in security of a claim to repayment

7.15 If it ceases to be competent to grant a standard security over a standard security, the question arises of whether an alternative mechanism is necessary for taking security over a standard security. In DP1, we asked whether it should be possible for a standard security to be assigned in security.[13] On reflection, we are no longer sure whether this is necessary. Where a primary claim to repayment is to be used as security for a secondary claim, this is effected by way of assignation in security. It might seem to follow that a standard security in respect of that primary claim should be assigned in security alongside it. However, this arrangement seems to face many of the same conceptual and practical difficulties as the grant of a secondary standard security over a primary standard security.

7.16 To explain the challenges, it is useful first to consider the nature and effect of an assignation in security of a primary claim. In such an arrangement, the assignor is the creditor in respect of the primary claim, which is used as security for a secondary claim owed to the assignee.

7.17 The right acquired by an assignee in an arrangement of this kind has been disputed. On one interpretation, an assignation in security results in a full divestiture of rights from the assignor to the assignee, in the same way as if the assignation had been absolute.[14] On

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[10] Companies Act 1985 s 462(1).
[11] For discussion see MacPherson, *Floating Charge* paras 5-12 to 5-32 and 9-04 to 9-12.
[12] DP1 para 5.28.
[13] See para 6.28-6.33 above.
[14] See, for example, *Redfearn v Sommervail* (1813) 5 Pat 707 at 713 (Lord Redesdale), *Bank of Scotland v Liquidators of Hutchison, Main & Co Ltd* 1914 SC (HL) 1 at 4 (Lord Kinnear) and *Ayton v Romanes* (1895) 3 SLT 203. See also Gloag and Irvine, *Rights in Security* 478: "the effect of intimation is to perfect the title of the assignee, not only against the debtor but also against the cedent and third parties claiming through him"; G L Gretton, "The

another, the assignee acquires a more limited form of security right.[15] In a detailed review of the authorities on this question,[16] Alisdair MacPherson notes that the full divestiture interpretation is now the prevailing view, and suggests that overturning it would be "highly problematic and at odds with aspects of the current law".[17] In our recent project on Moveable Transactions, we adhered to the view that an assignation in security differs from an absolute assignation in purpose but not in form,[18] and confirmed that reforms to the law on assignation of incorporeal moveables would apply equally to assignations in security of incorporeal moveables.[19] We continue to adhere to that view here.

7.18 Where a claim is assigned in security, the consequences which follow for the assignor and the assignee are generally regulated by the agreement between them. There is no statutory regime setting out their respective rights and obligations as in the case of a standard security. However, the law may imply certain rights and obligations where the parties have not made express provision.[20] The essence of the arrangement is that the assignor holds a personal right to retrocession (reconveyance) of the primary claim from the assignee on satisfaction of the secondary debt. As a result, the assignee has an obligation to account to the assignor for any sums received by the assignee in respect of the primary claim.[21] The case law provides guidance on the circumstances in which the assignation can provide security for further sums advanced after the assignation has been perfected, which may vary depending on whether the assignation is expressly in security, or whether the assignation is *ex facie* absolute qualified by a back letter.[22]

Assignation in security of a standard security

7.19 It might be assumed that an assignation in security of a standard security would produce similar consequences to assignation in security of a claim. However, these consequences seem to be unnecessary or inappropriate where the assigned property is a standard security. We consider each consequence further below.

The right to reconveyance

7.20 An assignation in security of a primary claim transfers that claim to the assignee, subject to the assignor's right to retrocession where the secondary claim is satisfied. Where that primary claim is secured by a standard security, the principle that accessory security rights

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Concept of Security" in D J Cusine (ed), *A Scots Conveyancing Miscellany: Essays in Honour of Professor J M Halliday* (1987) 126 at 130: "Devices exist in which legal ownership is vested in the creditor subject to a contract which confers on the debtor some sort of personal right in relation to the subject. Such devices clearly have much in common with securities, and some of them are in practice called securities…But, whereas in a true right in security there exist two real rights in the same subject…, in arrangements of this type there is only one real right, that of the creditor"; W A Wilson, *The Scottish Law of Debt* (2nd edn, 1991) para 8.1: "A security over incorporeal moveables is effected by assignation followed by intimation".

[15] See, for example, *Cleland Trs v Dalrymple's Tr* (1903) 6 F 262 at 267 (Lord President Kinross) and *Edinburgh Schools Partnership Ltd v Galliford Try Construction (UK) Ltd* [2017] CSOH 133 at para 120 (Lord Bannatyne).

[16] MacPherson, *Floating Charge* paras 9-37 to 9-66.

[17] MacPherson, *Floating Charge* para 9-65.

[18] Scottish Law Commission, Discussion Paper on Moveable Transactions (DP No 151, 2011) para 7.6.

[19] Report on Moveable Transactions para 13.44.

[20] See broadly Gloag and Irvine, *Rights in Security* 494-498; MacPherson, *Floating Charge* paras 9-19 to 9-21.

[21] *Marquis of Queensberry's Trustees v Scottish Union Insurance Company* 1839 1 D 1203; aff'd 1842 1 Bell's App 183.

[22] For an overview, see Gloag and Irvine, *Rights in Security* 491-492; MacPherson, *Floating Charge* para 9-22 to 9-25.

follow the claim[23] operates to entitle the assignee to acquire the standard security. Where the secondary claim is satisfied, and the assignor exercises their right to retrocession of the primary claim, they will also be entitled to reacquire the standard security in respect of that primary claim as a matter of the general law. Since the general law already provides for these consequences, it is unclear how the right to retrocession implied in an assignation in security would make sense here.

7.21 To explain further, as we noted in our Report on Moveable Transactions, the principle that the assignation of a claim should carry with it all accessory security rights is familiar in many legal systems.[24] Its application in Scots law will be clarified when the Moveable Transactions (Scotland) Act 2023 is brought into force. Sections 15(2) and (3) of the Act provide:

> "(2) Subject to anything that requires to be done under subsection (3), the assignee acquires, by virtue of the transfer of the claim, any security…which relates to, and only to, the claim transferred.
>
> (3) Where the performance of some act by the assignor is necessary for the security to transfer to the assignee, the assignor must—
>
> (a) perform that act, and
>
> (b) do so as soon as reasonably practicable after the claim is transferred."

This rule will operate as a default, but will be freely variable by the parties to the assignation by express provision in the assignation document.[25]

7.22 The effect of this provision will be that, where a primary claim secured by a standard security is assigned, the assignee will also be entitled to an assignation of the standard security. The assignor will be under an obligation to comply with the formalities required to complete that assignation.[26] Since the provisions on assignation of claims will apply equally where the assignation is for the purposes of security,[27] it follows that an assignee in security of a primary claim will be equally entitled to an assignation of a relevant standard security.

7.23 The provisions will also apply where the assignor exercises a right to retrocession. Assume that a primary claim has been assigned in security. The assignee has also acquired the standard security accessory to that primary claim under the provisions outlined above. The assignor then satisfies the secondary debt in respect of which the primary claim was assigned. The assignor exercises their right to retrocession, reacquiring the primary claim from the assignee. The provisions outlined above will again apply, entitling the assignor, on reacquisition of the primary claim, to also reacquire the accessory standard security.

7.24 The provisions set out above will apply where the standard security "relates to, and only to, the claim transferred". In modern practice, it is common for a standard security to be

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[23] Stair III.1.17; Erskine III.5.8; Bankton II, 191, 7. See also DP1 paras 10.3-10.4. This principle will be placed on a statutory footing by the Moveable Transactions (Scotland) Act 2023 when brought into force, as discussed below.
[24] Report on Moveable Transactions para 13.26.
[25] Moveable Transactions (Scotland) Act 2023 s 15(1)(b).
[26] We discuss the requirements for assignation of a standard security in DP1 ch 10.
[27] Report on Moveable Transactions para 13.44.

granted for "all sums due and to become due." A creditor may rely on such a security in respect of a number of claims against the same debtor. One difficulty which arises is where only one of those claims is assigned. In our Moveable Transactions project, we noted that the law in such circumstances probably entitles the assignor and the assignee to share the security[28] but that the results are complex and in practice parties would regulate this expressly.[29] Accordingly, we favoured the simple default rule now set out in section 15 of the Moveable Transactions (Scotland) Act 2023, which also expressly provides that parties are free to make alternative provision as to how securities are to be dealt with in the document assigning the claim.

7.25 Partial assignation of a standard security is competent under the current law[30] and there is no suggestion that should change under any new legislation. There are questions over what is required to comply with the formalities of assignation as set out in the 1970 Act, including a series of cases concerning whether the amount owed by the debtor at the time of assignation of an all-sums security must be specified in the document.[31] There is also uncertainty over the extent to which (i) sums owed to an assignee prior to the assignation and (ii) further advances made by the assignee following the assignation might be secured by an all-sums security.[32] Respondents to DP1 were strongly supportive of our proposals to streamline the law in this area. We anticipate that future legislation will remove any barriers presented by the 1970 Act to agreement between parties to an assignation in security of a claim who wish to vary the default rule under section 15 of the Moveable Transactions (Scotland) Act 2023 in relation to an accessory all-sums standard security.

7.26 Where a primary claim is assigned in security, and an accessory standard security follows it, this could, in a sense, be described as an assignation of the standard security "for the purposes of security". The primary claim has been assigned in security, and the standard security is of use only in relation to that claim. However, to consider the assignation of the standard security to be an "assignation in security" may imply that the assignor's right to reacquire the security flows from the nature of the assignation. As explained above, the assignor's right to reacquire the security seems more accurately characterised as a consequence of the principle that an accessory security right follows the claim. From this perspective, we think that allowing for a standard security to be assigned in security may tend to obfuscate, rather than illuminate, the operation of the law here.

The obligation to account

7.27 Where a claim is assigned in security, the assignee has an obligation to account to the assignor for sums obtained in respect of that claim. If the primary claim exceeds the secondary debt secured by it, and the primary claim is satisfied in full, the assignee may retain only what is required to satisfy the secondary debt, with any excess funds paid over to the assignor.

7.28 To apply these consequences to a standard security assigned in security makes little sense. The arrangement suffers from the same conceptual problem as where a standard security is granted over a standard security. The standard security itself is not a source of

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[28] See R G Anderson, *Assignation* (2008) paras 2-15 to 2-16; G L Gretton, "Assignation of all-sums standard securities" 1994 SLT (News) 207 at 208-209.
[29] Report on Moveable Transactions para 13.29.
[30] 1970 Act, s 14(1).
[31] DP1 paras 10.9-10.60.
[32] Ibid.

funds. It is a mechanism to increase the likelihood that the primary claim will be satisfied. The duty of the assignee to account to the assignor for funds obtained in satisfaction of the primary claim flows from the assignation in security of that claim. This will include funds obtained to satisfy the primary claim through exercise of the security. Since the security itself has no market value, as discussed in para 7.7 above, it is difficult to understand what purpose an obligation to account could serve here.

Alternative consequences?

7.29 The analysis above considers the main consequences which flow from assignation in security of a claim, and suggests that these consequences are unnecessary or inappropriate for assignation in security of a standard security. It would, of course, be possible to provide in any new legislation for different consequences where a standard security is assigned in security. However, it is difficult to see what sensible provision might be made here, bearing in mind that a standard security has no market value.

7.30 One suggestion which came to our attention concerns the assignor's title to sue the primary debtor following an assignation in security of a primary claim. In *The Edinburgh Schools Partnership Limited v Galliford Try Construction UK Limited*,[33] Lord Bannatyne found that an express assignation in security of rights under a contract did not divest the assignor of title to sue in respect of those rights, since the assignor may retain an interest.[34] In the authorities relied on, the continuing interest of the assignor related to the fact that the property assigned in security had a value higher than the claim it secured.[35] In the case itself, the ongoing financial interest of the assignor in the assigned property was clear from the terms of the assignation contract, under which (amongst other things) the primary debtor was directed to make payment to the assignor, not to the assignee.[36]

7.31 It is not wholly clear how this doctrine would operate if applied to an assignation in security of a standard security. On one view, it would be impossible for an assignor to have a continuing financial interest in a standard security, since it has no value except as an accessory to the primary claim. On a broader view, an assignor with a continuing financial interest in the primary claim may wish to exercise a standard security which enforces performance of that primary claim. But complex questions may arise where more than one party holds a right to exercise a standard security, particularly in connection with the debtor protection obligations owed to the primary debtor in such circumstances.

7.32 We note provision under the Moveable Transactions (Scotland) Act 2023 to clarify that the assignor may continue accepting performance from the primary debtor following an assignation of the primary claim, acting as an agent of the assignee in this respect.[37] There seems no reason why parties could not also come to an agreement on circumstances in which the assignor could act as an agent of the assignee in respect of the standard security also. Requiring express provision for such arrangements, rather than relying on a right which may be imputed to the assignor following an assignation in security of a standard security, seems a preferable approach for all parties, particularly the primary debtor.

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[33] [2017] CSOH 133.
[34] [2017] CSOH 133 at para 132.
[35] [2017] CSOH 133 at paras 123-132.
[36] [2017] CSOH 133 at para 140.
[37] Moveable Transactions (Scotland) Act 2023 s 16(1)(b).

7.33 Beyond that, it is not clear to us what consequences flowing from an assignation in security of a standard security would be necessary or desirable. We have given thought here to the circumstances in which secondary standard security arrangements are put in place in current practice.[38] In securitisations and other debt restructuring arrangements, the secondary creditors (in other words, the investors) will remain able to take an assignation in security of the mortgage book claims where required, and may also acquire the associated standard securities under the operation of the provisions of the Moveable Transactions (Scotland) Act 2023 outlined above. The use of secondary standard securities to protect the priority of obligations to transfer land may, in future, be dealt with through the reforms to the law on *ad facta praestanda* standard securities we outline earlier in this paper.

7.34 In short, we do not think there is a need in any new legislation to make provision for assignation in security of a standard security. However, we would be grateful for the views of consultees.

7.35 We ask:

19. (a) Should it be possible to assign in security a standard security?

(b) If so, what consequences should follow from such an assignation in security?

Statutory pledge

7.36 For completeness, we note that the Moveable Transactions (Scotland) Act 2023 makes provision for a new form of right in security known as a statutory pledge.[39] It will be possible to grant a statutory pledge over certain classes of incorporeal moveable property, thereby creating a subordinate real right in security in that property.[40]

7.37 The Act does not provide for the grant of a statutory pledge over claims to repayment. In our Report on Moveable Transactions, we considered there to be two major barriers to the grant of a statutory pledge over such claims, namely its interaction with the existing power to assign claims in security, and the difficulty with "controlling" the proceeds realised under such security as required for compliance with insolvency law more generally.[41] We noted, however, that the position in relation to these difficulties may change in future, particularly if there is reform to corporate insolvency law.[42]

7.38 We do not think there would be any benefit in exploring the potential for a statutory pledge to be granted over a standard security for the same reasons we think it is incoherent to grant a standard security over a standard security. If the statutory pledge regime is reformed at some later stage to allow for the grant of such a pledge over claims to repayment, the position in relation to securities accessory to such claims, including standard securities, would have to be revisited. We do not offer here any view on how that issue should be addressed.

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[38] See discussion at paras 6.21-6.27.
[39] Moveable Transactions (Scotland) Act 2023 ss 43-57.
[40] For an overview, see Scottish Government, *Policy Memorandum on the Moveable Transactions (Scotland) Bill (SP Bill-15 PM) (2022)* para 37.
[41] Report on Moveable Transactions paras 22.5-22.18.
[42] Report on Moveable Transactions para 22.18.

Chapter 8 Summary of questions

1. What information or data do consultees have on:

   (a) the economic impact of the current legislation on heritable securities in relation to transactions involving non-monetary securities or secondary standard securities?

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

   (Paragraph 1.21)

2. Which of the following approaches do consultees prefer and why?

   (a) A standard security may not secure a non-monetary obligation, but it may secure an obligation to pay damages for non-performance of that obligation.

   (b) A standard security may secure a non-monetary obligation, but the security will entitle the holder only to damages for non-performance of that obligation.

   (Paragraph 3.12)

3. If a standard security under any new legislation entitles its holder only to monetary remedies:

   (a) Is specific provision required to deal with the ranking of such a security?

   (b) If so, what provision is required?

   (Paragraph 3.17)

4. Should the law provide a means by which contractual obligations to transfer or grant subordinate real rights in land can be protected beyond the usual contractual remedies?

   (Paragraph 4.14)

5. Which of the following approaches do consultees prefer?

   (a) A party wishing to protect the priority of an obligation to transfer or grant a subordinate real right in land should continue to take a standard security in respect of that obligation and rely on the rule against offside goals to protect that obligation.

   (b) The law should be reformed to provide a bespoke mechanism for protecting the priority of an obligation to transfer or grant a subordinate real right in land.

   (Paragraph 4.20)

6. If a new form of notice is introduced to protect the priority of obligations to transfer land or grant a subordinate real right, should this be known as a conditional advance notice? If not, what name should be used?

(Paragraph 4.34)

7. If a conditional advance notice scheme is introduced:

(a) Should the conditional advance notice include the same content as the advance notice?

(b) Should the conditional advance notice also include identification of the contract or undertaking in which the obligation to grant the intended deed is set out?

(c) Should any further information be included in the conditional advance notice?

(Paragraph 4.39)

8. If a conditional advance notice scheme is introduced:

(a) Should it be possible for an application for a conditional advance notice to be made by the person with the power to validly grant the intended deed?

(b) Should it be possible for an application for a conditional advance notice to be made by any other person? If so, which person and why?

(Paragraph 4.46)

9. If a conditional advance notice scheme is introduced:

(a) Where the intended deed relates to a property in the Land Register, should a conditional advance notice be entered on the title sheet of that property?

(b) If so, in which section of the title sheet should it be noted?

(c) If not, where in the Land Register should the conditional advance notice be located?

(d) Where the intended deed relates to a property in the Register of Sasines, should a conditional advance notice be recorded in that Register?

(Paragraph 4.54)

10. If a conditional advance notice scheme is introduced:

(a) What should be the duration of the protected period and why?

(b) At the end of the protected period, should it be possible to extend the period by the same fixed duration? If not, why not?

(c) Should it be possible for the person intending to grant the deed to extend the period of the notice? Should it also be possible for the intended grantee of the deed to extend the period of the notice? If not, why not?

(Paragraph 4.61)

11. If a conditional advance notice scheme is introduced:

(a) Should the priority of the deed specified in the notice be protected against any voluntary competing deed registered during the protected period? If not, why not?

(b) Should performance of the obligation to deliver the deed specified in the notice be protected against any voluntary competing deed registered during the protected period? If not, why not?

(Paragraph 4.74)

12. If a conditional advance notice scheme is introduced, should the priority of the deed specified in the notice be protected against:

(a) Any involuntary competing deed registered during the protected period?

(b) An inhibition, or another entry in the Register of Inhibitions which takes effect as if an inhibition, during the protected period?

Please provide reasons in support of your answers if you wish.

(Paragraph 4.80)

13. If a conditional advance notice scheme is introduced, should it be provided that:

(a) Where the claim protected by the notice is assigned, the assignee acquires the right to the notice;

(b) The intended grantee of the protected deed has the power to apply for transfer of the notice, and must do so where necessary to transfer the notice following assignation of the protected claim?

(Paragraph 4.84)

14. If a conditional advance notice scheme is introduced:

(a) Should provision be made for discharge of the notice as under the advance notice scheme, subject to the reform of the requirement of consent from the intended recipient?

(b) Should the intended recipient be required to consent to the discharge application in writing?

(c) Should a court process be available for discharge where the intended recipient cannot be found, fails to respond or refuses to consent?

(Paragraph 4.92)

15. Do you have any comments on the use of conditional advance notices in relation to purchase options held by tenants in respect of the property they lease?

(Paragraph 4.98)

16. Is further exploration required of the potential to protect obligations to transfer land by way of a standard security, a personal real burden or an inhibition? If so, why?

(Paragraph 5.24)

17. In what circumstances is a standard security taken over a standard security in practice?

(Paragraph 6.27)

18. Should the grant of a standard security over a standard security cease to be competent? If not, why not?

(Paragraph 7.14)

19. (a) Should it be possible to assign in security a standard security?

(b) If so, what consequences should follow from such an assignation in security?

(Paragraph 7.35)

Appendix

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