

THE CIRCLE SQUARED? FLOATING CHARGES AND DILIGENCE AFTER *MACMILLAN V T LEITH DEVELOPMENTS LTD*

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Introduction

In February 1977 the First Division issued its majority judgment in *Lord Advocate v Royal Bank of Scotland Ltd*.¹ It held that an arrestment without furthcoming was not “effectually executed diligence” on property for the purposes of the (then-applicable) floating charges legislation,² and therefore a receiver’s powers were not subject to an arrester’s rights. The case has since been a source of criticism and interest for commentators.³ However, there was little sign that the case would be judicially challenged. Courts accepted the correctness of the decision and the ratio was also considered to apply to inhibitions, so that an inhibition without adjudication was not deemed to be effectually executed diligence.⁴ It appeared that legislative amendment would be a more likely possibility.⁵ Then, on 10 March 2017, a five-judge First Division bench in *MacMillan v T Leith Developments Ltd*⁶ unanimously overturned *Lord Advocate v RBS*.

The decision in *MacMillan* was undoubtedly correct. Yet, despite the case resolving certain issues regarding the relationship between floating charges and diligence, there remain points of concern and *MacMillan* itself also exacerbates particular problems. This article will analyse the opinions in *MacMillan* and will examine the implications of the current interpretation of “effectually executed diligence”, as used in

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¹ 1977 S.C. 155.

² Companies (Floating Charges and Receivers) (Scotland) Act 1972 s.15(2)(a). The equivalent provisions are now in the Insolvency Act 1986 s.55(3)(a).

³ See e.g. W.A. Wilson, “Prior Arrestment of Funds and Floating Charges (Scotland)” 1978 JBL 367; W.A. Wilson, “Effectively Executed Diligence” 1978 Jur. Rev. 253; G.L. Gretton, “Diligence, Trusts and Floating Charges – I: ‘Effectually Executed Diligence’” (1981) 26 JLSS 57; G.L. Gretton, “Inhibitions and Company Insolvencies” 1983 S.L.T. (News) 145; A.J. Sim, “The Receiver and Effectually Executed Diligence” 1984 S.L.T. (News) 25; S. Wortley, “Squaring the Circle: Revisiting the Receiver and ‘Effectually Executed Diligence’” 2000 Jur. Rev. 325.

⁴ See *Armour and Mycroft, Petrs* 1983 S.L.T. 453, in which the respondents departed from a contrary argument regarding inhibitions (the Lord Ordinary (Kincaid) was also the judge at the Outer House stage of *Lord Advocate v RBS*); *Taymech Ltd v Rush and Tompkins Ltd* 1990 S.L.T. 681; *Iona Hotels Ltd (in Receivership) v Craig* 1990 S.C. 330 per Lord President Hope at 334-335, who agreed with the decision in *Lord Advocate v RBS*, but distinguished it. (Lord Hope had acted as junior counsel in *Lord Advocate v RBS* and as senior counsel in *Armour*, where his junior was the future Lord Drummond Young.)

⁵ See the proposal in Scottish Law Commission, *Discussion Paper on Moveable Transactions* (DP 151) (2011), paras 22.33-22.34, to reverse *Lord Advocate v RBS* by legislation. This was also the approach recommended in Wortley, “Squaring the Circle” 2000 Jur. Rev. 325, 344-346, to avoid difficulties of opening up past transactions (see further below). Following the decision in *MacMillan*, the Scottish Law Commission does not propose legislative reform regarding the matter in its *Report on Moveable Transactions* (Scot Law Com No 249) (2017), paras 38.10-38.12; however, it considers that certain issues should be addressed when corporate insolvency law is next reviewed.

⁶ [2017] CSIH 23; 2017 S.C. 642. Hereafter “*MacMillan*”.

the floating charges legislation. It will then consider the status of diligence in receivership, liquidation and administration, before discussing further ranking issues and the notion that floating charges are incompatible with the law of diligence. This study explores these matters in light of *MacMillan* and also addresses a number of points that have not previously been examined. It deals with the interface between the laws of rights in security, diligence and corporate insolvency, which are areas of considerable technical complexity and practical import.

Macmillan v T Leith Developments Ltd

Facts and Background

T Leith Developments Ltd (“TLD”) granted a floating charge over all of its property and undertaking to Clydesdale Bank (“the Bank”) on 30 November 2000. A number of years later, in September 2006, Mr and Mrs MacMillan raised a breach of contract action against TLD and inhibited TLD (on the dependence). The MacMillans obtained decree by default on 30 November 2010. A few months afterwards, in February 2011, the Bank appointed joint receivers to TLD, which caused the Bank’s floating charge to attach.⁷ A liquidator (provisional and then interim) was also subsequently appointed to TLD. By the date of the receivership, the whole debt due to the Bank had been incurred after the inhibition. TLD’s principal assets were two houses.

Mr MacMillan⁸ sought declarator that the inhibition was “effectually executed diligence” and, therefore, when proceeds of sale of the houses were being distributed, he required to be paid before the Bank.⁹ Secondly, he contended that, in any event, the inhibition gave him priority over the debt payable to the Bank. In the Outer House,¹⁰ Lord Tyre considered himself bound by *Lord Advocate v RBS* but did acknowledge that an inhibition’s nature could confer priority over a subsequently created floating charge, as an inhibition prohibits future voluntary acts. Unfortunately for Mr MacMillan, his inhibition post-dated the Bank’s floating charge and the charge’s subsequent attachment was not voluntary. However, Lord Tyre held that an inhibition created a preference over post-inhibition advances by a floating charge holder, irrespective of whether the inhibition was “effectually executed diligence”.

The defender reclaimed to the Inner House and Mr MacMillan cross-appealed, arguing that the inhibition was “effectually executed diligence”, that *Lord Advocate v RBS* was wrongly decided and, even if it was not, the decision did not apply to inhibitions. The attempt to overturn *Lord Advocate v RBS* led to the convening of a five-judge bench.

⁷ Insolvency Act 1986 s.53(7).

⁸ As an individual and as executor for his wife.

⁹ See Insolvency Act 1986 s.60(1), for the distribution ranking list; and s.55(3)(a) provides that the powers of a receiver over the company’s property are subject to the rights of a party with effectually executed diligence.

¹⁰ [2016] CSOH 19; 2016 S.L.T. 477. For discussion, see A.D.J. MacPherson, “In the Twilight Hour? The Ranking of Floating Charges and Inhibitions” (2016) 20 EdinLR 353.

Decision

The Lord President (Lord Carloway), Lord Drummond Young and Lord Malcolm each gave substantive opinions. Lords Menzies and Brodie concurred with the Lord President. Therefore, on points of divergence the Lord President's opinion provides the case's ratio. The judges were, nevertheless, unanimous that inhibition is "effectually executed diligence" and that Mr MacMillan had priority over the Bank.¹¹

The court held that *Lord Advocate v RBS* undermined the effect of diligence. It was noted that the statutory references to effectually executed diligence were meant to be "saving provisions" preserving the law of diligence in competition with floating charges.¹² The interpretation of "effectually executed diligence" in *Lord Advocate v RBS* rendered such provisions of little or no effect. The term actually means a validly executed diligence not struck down by being executed within 60 days of the debtor company's liquidation, and includes inhibition as well as arrestment without furthcoming.¹³ Interestingly, the Lord President did not consider the meaning of effectually executed diligence to be "in the least ambiguous" and thus the use of canons of statutory construction to interpret uncertain wording was unnecessary.¹⁴ The Lord President's interpretation of the term is correct, but there is undoubtedly some ambiguity in its meaning. This is evidenced by the views of the Lord Ordinary and the majority in *Lord Advocate v RBS*, and Lord Hope, as commentator, counsel and judge,¹⁵ and was also recognised by Lord Drummond Young in *MacMillan*.¹⁶

Despite the Lord President rejecting the need for interpretive aids, it was acknowledged that they supported the court's position on the meaning of effectually executed diligence.¹⁷ The term "effectual" was used in the Companies Act 1948, s.327, in relation to the 60-day rule for arrestment and poinding. And this legislation was in force, and apparently directly influential, when the floating charge and the phrase "effectually executed diligence" were introduced by the Companies (Floating Charges) (Scotland) Act 1961 ("1961 Act"). The word "effectual" also appears in successor legislation with respect to the 60-day rule.¹⁸ In addition, the court's interpretation was supported by the promoter of the Bill that became the 1961

¹¹ Paras 42ff per Lord President; paras 75ff per Lord Drummond Young; paras 123ff per Lord Malcolm.

¹² Para 57 per Lord President; paras 128-129 per Lord Malcolm.

¹³ Paras 56-57 per Lord President; paras 94ff per Lord Drummond Young.

¹⁴ Para 56 per Lord President.

¹⁵ See above n 4 and J.A.D. Hope, "Inhibitions and Company Insolvencies: A Contrary View" 1983 S.L.T. (News) 177.

¹⁶ Para 76.

¹⁷ Paras 58-59 per Lord President; paras 98ff per Lord Drummond Young.

¹⁸ Previously the Bankruptcy (Scotland) Act 1985 s.37(4) and now the Bankruptcy (Scotland) Act 2016 s.24(6), with both provisions applied to liquidations by the Insolvency Act 1986 s.185(1)(a).

Act,¹⁹ Forbes Hendry MP, in Parliamentary statements. These statements could have been called upon by the application of *Pepper v Hart*²⁰ if the wording had not been deemed unambiguous.²¹

The court also held that the post-*Lord Advocate v RBS* statutory re-enactment of the “effectually executed diligence” provisions was not parliamentary endorsement of *Lord Advocate v RBS*. Their Lordships decided that the principle from *Barras v Aberdeen Steam Trawling and Fishing Co*²² is only an aid to construction, is not conclusive and does not apply to consolidation statutes, such as the Companies Act 1985 (“1985 Act”) and the Insolvency Act 1986 (“1986 Act”).²³

It was acknowledged that *Lord Advocate v RBS* had represented settled practice for 40 years and that the courts will generally be slow to reverse a decision where practice has been settled.²⁴ But, in the view of Lord Drummond Young, it is necessary to distinguish between two types of “settled practice”: firstly, where a section of the public “order their affairs” on the basis that a previous court decision is correct; and, secondly, where cases have been decided or a settlement has been reached in reliance on earlier precedent but there has been “no wider impact on commercial or professional or administrative practice”.²⁵ Lord Drummond Young considered that the first type would be more likely to cause a court to hesitate in reversing a decision, due to difficulties that would arise from the unravelling of transactions. However, he deemed *Lord Advocate v RBS* to be an example of the second type and that form of settled practice did not restrict the court in overturning an earlier case. In the Lord President’s view, the absence of ambiguity meant that settled practice “cannot convert the ordinary legal meaning of the words used into something conveying a different sense”.²⁶ As such, it would not be justified to persist with the incorrect interpretation of effectually executed diligence in *Lord Advocate v RBS*. Much more could be said regarding the statutory interpretation issues involved in *MacMillan*; however, for reasons of space, that will not be possible here.

“Effectually Executed Diligence”

The Meaning of “Effectually Executed”

On the basis of *MacMillan*, what does it mean to say that diligence is “effectually executed”? The first point is that diligence will not meet the definition if it is invalidly executed, or if it is a type of diligence that is

¹⁹ Where the terminology was first used and from which the wording was taken for the Companies (Floating Charges and Receivers) (Scotland) Act 1972 and subsequent legislation.

²⁰ [1993] A.C. 593.

²¹ Unlike the Lord President, Lord Drummond Young considered that reference to the Parliamentary material was permitted: para 98.

²² [1933] A.C. 402.

²³ The Companies Act 1985 was not technically a consolidation statute, but can be treated as such in a broad sense: per Lord President at para 65. The court in *MacMillan* endorsed the position of Lord Diplock in *Haigh v Charles W Ireland Ltd* 1974 S.C. (HL) 1 at 40: para 65 per Lord President and para 109 per Lord Drummond Young.

²⁴ See, for example, *R (on the application of N) v Lewisham LBC* [2015] A.C. 1259.

²⁵ Paras 111-113 per Lord Drummond Young.

²⁶ See paras 66ff per Lord President and paras 110ff per Lord Drummond Young.

rendered ineffectual by being executed within 60 days of liquidation or thereafter.²⁷ This 60-day rule already applied to arrestment and poinding when the floating charge was introduced. Since the replacement of poinding by attachment, the rule now applies to attachment (and to interim attachment and money attachment).²⁸ Under the Bankruptcy (Scotland) Act 1985, s.37(2), an equivalent rule was created for inhibition, but the use of the term “effectual” in that context was removed by the Bankruptcy and Diligence etc (Scotland) Act 2007 (“2007 Act”), and has been omitted from the Bankruptcy (Scotland) Act 2016 (“2016 Act”).²⁹ Nevertheless, the operation of s.24(3) of the 2016 Act, in combination with the 1986 Act, s.185, means that any inhibition taking effect within 60 days of liquidation causes “any relevant right of challenge” and “any right of the inhibitor to receive payment for the discharge of the inhibition” to vest in the liquidator. As such, an inhibition within 60 days of liquidation cannot be considered “effectually executed diligence” in favour of the inhibitor.

Although the various forms of the 60-day rule are not triggered by the debtor company commencing receivership, if a company in receivership enters liquidation then the rule applies. Consequently, it may be advantageous (in some situations) for a receiver or chargeholder to push the company into liquidation to defeat the diligence creditor.³⁰

Inhibition and Arrestment as Effectually Executed Diligence

A second, obvious, point is that something must be classified as diligence to be effectually executed diligence. In *MacMillan* the court examined authorities such as Bell’s *Commentaries* and Stewart on *Diligence* to conclude that inhibition is a diligence which prohibits the debtor from subsequently alienating or otherwise dealing with its heritable property to the prejudice of the inhibitor.³¹ As the Lord President stated, inhibition’s status as a diligence is also acknowledged by Scots lawyers and insolvency practitioners.³²

Given that we are concerned here with floating charges and inhibition, it is worthwhile to note that interesting comparisons can be drawn between them. Some writers state that, historically, inhibition applied universally to property, heritable and moveable.³³ This is analogous to the floating charge’s coverage of property. But a floating charge permits a debtor to deal with its property while an inhibition is intended precisely to prohibit such dealing. In fact, certain commentators have even suggested that inhibition originated in Scots law as a preventative measure to stop the debtor dealing with property that was subject

²⁷ See below regarding the potential for a slightly expanded meaning to incorporate equalisation of diligences.

²⁸ 2016 Act s.24(6), as applied to liquidation by the 1986 Act s.185(1)(a).

²⁹ 2016 Act s.24(3).

³⁰ For discussion, see Wortley, “Squaring the Circle” 2000 Jur. Rev. 325, 341ff; and see 345-346 regarding the argument in favour of diligences struck down by the 60-day rule accruing for the benefit of unsecured creditors rather than the floating charge holder.

³¹ Paras 42ff per Lord President. E.g. G.J. Bell, *Commentaries*, 7th edn by J. McLaren, (1870), 1, 5; G. Watson, *Bell’s Dictionary and Digest of the Law of Scotland*, 7th edn (1890), 325; and J.G. Stewart, *A Treatise on the Law of Diligence* (1898), 551ff.

³² Para 47.

³³ See e.g. Stewart, *Diligence*, 525-526 and Bell, *Commentaries*, II, 135.

to a general hypothec over his whole property.³⁴ Ultimately, however, inhibition was limited to heritable property and the extent to which hypothecs were admitted into early Scots law is a matter of dispute.³⁵

The assertions in *MacMillan* regarding inhibition's status as "effectually executed diligence" on property were supported by consideration of its effects. Despite the fact that inhibition does *not* create a real right, it: (i) renders the debtor's heritable property "litigious", thereby prohibiting the debtor from granting prejudicial voluntary deeds in future; and (ii) postpones post-inhibition debts to the inhibitor's claims.³⁶ Although both effects were live law in *MacMillan*, s.154 of the 2007 Act provides that inhibition "does not confer any preference" in insolvency proceedings (and other ranking processes), including liquidation, receivership and administration. Despite the wide wording of that provision, the court in *MacMillan* commented that only effect (ii) has been abolished.³⁷ It is not obvious though how effect (i) could be given effect to in a receivership or liquidation without the inhibitor receiving a preference within those processes.³⁸ For example, a floating charge is granted by an inhibited debtor and the debtor later enters liquidation. The inhibition would presumably allow for the floating charge to be reduced (as a later voluntarily granted security), but the effect of such reduction is only *ad hunc effectum* (i.e. only effective between the inhibitor and the chargeholder, for other purposes the floating charge is not reduced).³⁹ Consequently, the inhibitor would need to be given a preference in the liquidation, which would involve him being ranked against the competing claims of the floating charge holder, the ordinary unsecured creditors, preferential creditors and others. Section 154 should be given a narrow meaning limited to the removal of effect (i), with inhibition retaining its priority as regards effect (i) in liquidation,⁴⁰ even if the inhibitor requires to receive priority in a ranking process.⁴¹

There is a further related problem for receivership and inhibition, where an inhibition ranks ahead of a later-created floating charge but there are also unsecured creditors due to be paid post-inhibition debts. Is the receiver required, under s.60 of the 1986 Act, to distribute proceeds to the inhibitor despite the existence of post-inhibition creditors? There is an unfortunate conflict here between s.60 of the 1986 Act and s.154 of the 2007 Act.

Effect (ii) was relevant in *MacMillan* because the debt due to the floating charge holder was post-inhibition debt. But what if that debt had been pre-inhibition, or it was a post-2007 Act case? The answer

³⁴ E.g. W. Ross, *Lectures on the History and Practice of the Law of Scotland: Relative to Diligence and Conveyancing*, 2nd edn (1822), pp.459-465; Stewart, *Diligence*, 525-526. For further discussion, see J. MacLeod, "Fraud and Voidable Transfer: Scots Law in European Context" (PhD Thesis, University of Edinburgh) (2013), pp.144-147.

³⁵ On the latter, see A.J.M. Steven, "Rights in Security over Moveables" ch 8 in R. Zimmermann and K.G.C. Reid (eds), *A History of Private Law in Scotland* (2000), pp.335-336.

³⁶ See *MacMillan* paras 44-46.

³⁷ Para 79 per Lord Drummond Young.

³⁸ See also the discussion at MacLeod, "Fraud and Voidable Transfer", pp.162-164.

³⁹ See G.L. Gretton, *The Law of Inhibition and Adjudication*, 2nd edn (1996), pp.129-130; Erskine, *Institute*, II, 11, 14.

⁴⁰ And certain other processes involving ranking such as sequestration. The positions for receivership and administration are more complicated and will be discussed below.

⁴¹ This approach would be more in line with the recommendations in Scottish Law Commission, *Report on Diligence* (Scot Law Com No 183) (2001), paras 6.43-6.47. See also *Playfair Investments Ltd v McElvogue* [2012] CSOH 148; 2013 S.L.T. 225, where Lord Hodge used the Scottish Law Commission's *Report on Diligence* to help interpret s.160 of the 2007 Act.

depends upon whether inhibition being effectually executed is enough for it to prevail against a floating charge or whether it must be effectually executed *and* rank ahead on the basis of its recognised effect in wider law. Their lordships emphasised the prohibitory characteristics of inhibition and considered that the relevant floating charge provisions were intended to preserve the rights of diligence creditors in competition with a floating charge.⁴² Certainly, the wording of the provisions, whereby distribution to the chargeholder or the powers of a receiver are subject to “the rights” of those with effectually executed diligence, can naturally be read in this way.⁴³ If the inhibitor has no identifiable rights in the law of diligence that would allow it to rank ahead of the floating charge, it will not do so. As Mr MacMillan’s inhibition was preceded by the floating charge’s creation, there would be no future voluntary deed involving the charge over which the inhibition would give priority. This seems the most likely position based on the court’s preference for a solution fitting the floating charge into wider law, including the law of diligence.

Much emphasis, however, was placed by the court on arrestment’s prohibitory nature for moveable property, as an equivalent to inhibition’s status for heritable property.⁴⁴ Arrestment without furthcoming (or equivalent) was recognised as a diligence that could be “effectually executed”.⁴⁵ The judges did not state a confirmed view on the nature of arrestment, but it is possible to discern a degree of favourability for the so-called “prohibition theory”, despite some seemingly contrary comments by Lord Drummond Young.⁴⁶ Like for inhibition, it was accepted that arrestment does not give a real right without further legal process (adjudication for inhibition and furthcoming or the automatic release of funds for arrestment).⁴⁷ But the court considered that this does not matter as the effects of these diligences give priority to the diligence creditors even within processes like sequestration and liquidation, where competing parties obtain the equivalent of a real right.⁴⁸ If the effects of inhibition and arrestment cannot be separated, an effectually executed inhibition would apparently always prevail against a floating charge, no matter whether it became effective before or after the charge’s creation. This is because the court in *MacMillan* held that *Lord Advocate v RBS* was wrongly decided and that case featured an arrestment executed *after* the creation of a floating charge.

⁴² Para 57 per Lord President; paras 128-129 per Lord Malcolm.

⁴³ 1986 Act ss.55(3)(a) and 60(1). An alternative reading is, however, possible. By stating that e.g. distribution to a floating charge holder is subject to the rights of those with effectually executed diligence (in 1986 Act s.60(1)), this could simply be a means of recognising that a floating charge is automatically postponed to such diligence, without having to consider the particular effects of the diligence in each case: see also MacPherson, “In the Twilight Hour?”, 357-359.

⁴⁴ E.g. paras 48 and 60 per Lord President; paras 84 and 103 per Lord Drummond Young. See also *Burnett’s Tr v Grainger* [2004] UKHL 8; 2004 S.C. (H.L.) 19, per Lord Hope at para 22.

⁴⁵ Para 56 per Lord President.

⁴⁶ See e.g. paras 56-60 per Lord President; para 84 per Lord Drummond Young. For the prohibition theory, see G.L. Gretton, “Diligence”, in *The Laws of Scotland: Stair Memorial Encyclopaedia*, vol.8 (1992), para 285.

⁴⁷ Para 57. If funds are arrested (e.g. sums in a bank account), they are automatically released by the arrestee to the arrester after 14 weeks, unless there is an objection: see Debtors (Scotland) Act 1987 ss.73J-73N.

⁴⁸ Due to sequestration having the effect of various diligences, such as adjudication, arrestment and attachment (in relation to diligence done), by virtue of 2016 Act s.24(1)-(2), as applied to liquidation by 1986 Act s.185(1)(a). Adjudication will be replaced by land attachment if Part 4 of the Bankruptcy and Diligence etc (Scotland) Act 2007 is brought into force, but a sequestration or liquidation will not have the effect of a land attachment. Instead, see 2016 Act s. 23A.

Yet arrestment and inhibition can be distinguished. While both have prohibitory effect, an arrestment also gives a more general preference over competing rights. An arrestment confers priority in arrested property over unsecured creditors, whenever the debts were incurred, and is not just limited to priority over post-diligence debts, as per former effect (ii) of inhibition. In addition, inhibition usually requires a further diligence, such as adjudication for debt or arrestment, to confer any right to claim inhibited property or its proceeds; while arrestment alone gives the arrester preference rights to arrested property. If the “attachment theory” of arrestment, preferred by Professor Gretton,⁴⁹ was adopted, it would be even easier to distinguish between the operation of arrestment and inhibition in opposition to a floating charge. Given the priority of arrestment over property in competition with later-created rights, such as a second arrester or an assignee following intimation, the attachment theory is a more appropriate approach to the nature of arrestment.⁵⁰

The reasoning in Lord Drummond Young’s opinion departed from the other judges. He referred to arrestment and inhibition as security rights, in the wide sense outlined by Gloag and Irvine,⁵¹ and noted that a chargor has freedom to deal with property subject to a charge, including being free to create security rights.⁵² The appointment of the receiver (or equivalent) is when this freedom stops. As Lord Drummond Young stated, diligence differs from other security rights as it is created by the act of a creditor, not the debtor, and is not prohibited by a negative pledge. Giving effect to security rights, including diligence, is “wholly consistent with the nature of a floating charge”.⁵³ Lord Drummond Young was therefore of the view that an “inhibition or arrestment effected against the estate of a company that had granted a floating charge would prevail over that floating charge at the time of attachment.”⁵⁴ For inhibition, this must now be considered subject to the provisions of s.154 of the 2007 Act.

It should also be noted that if inhibition takes effect after a floating charge is created, it is expressly stated not to be “effectual diligence” for the purposes of the 1986 Act, s.61(1).⁵⁵ Section 61 provides that a receiver can only deal with property upon obtaining the consent of the court or a fixed security holder or a party with effectually executed diligence (as appropriate). The intention of the inhibition provision is to allow a receiver to deal with property unrestricted by an inhibition that post-dates the floating charge.⁵⁶

⁴⁹ Gretton, “Diligence”, *SME*, para 285.

⁵⁰ See also, Wortley, “Squaring the Circle” 2000 *Jur. Rev.* 325, 334.

⁵¹ W.M. Gloag and J.M. Irvine, *Law of Rights in Security: Heritable and Moveable Including Cautionary Obligations* (1897), pp.1-2.

⁵² Paras 77-78. Lord Drummond Young is primarily referring to arrestment and inhibition on the dependence here but also draws equivalence with “diligence proceeding on a document of debt”. For some scepticism about whether diligence can be covered by Gloag and Irvine’s definition of rights in security, see J. MacLeod, “Thirty Years After: The Concept of Security Revisited” in A.J.M. Steven, R.G. Anderson and J. MacLeod (eds), *Nothing so Practical as a Good Theory: Festschrift for George L. Gretton* (2017), pp.182-3.

⁵³ Para 81.

⁵⁴ See also para 89.

⁵⁵ 1986 Act s.61(1A). There is also a provision, not yet in force, which provides that an arrestment is only an effectual diligence where it is executed before the floating charge attaches: s.61(1B).

⁵⁶ The provision’s construction is clumsy, but see e.g. *Bankruptcy and Diligence etc (Scotland) Act 2007 Explanatory Notes*, para 430. This also stops any argument that an inhibition which becomes effective after a floating charge is created places a prohibition on transfer of inhibited property by a receiver.

A Complete Code?

The court in *MacMillan* also gave attention to whether, irrespective of the meaning of “effectually executed diligence”, an inhibition prevailed over post-inhibition debts (under the old law). This revolved around the extent to which the receivership distribution provisions in the 1986 Act, s.60, constitute a code, or whether a party can have priority by virtue of external rules, such as a diligence’s general effects. The Lord President considered s.60 to provide a code, but an incomplete one, as it refers to the rights of those with effectually executed diligence, which requires paying attention to what the diligence in question (e.g. inhibition) entitles the creditor to do.⁵⁷ It is true that the “code” involves external references to identify parties within the different categories. The statutory provision in s.60 is a mechanism by which wider law, including the law of diligence, determines what falls within each of the distribution categories, while s.60 provides the ranking order between those categories.⁵⁸ It is also necessary to use external ranking rules to find out what the order is among particular rights *within* a given category (e.g. if there are two effectually executed diligences or two fixed securities ranking ahead of the floating charge), as s.60 does not specify this.⁵⁹ Nor does s.60 outline what causes a fixed security to rank ahead of a floating charge and thus fall into the prior-ranking fixed securities category, s.464 of the 1985 Act must be used for that purpose. The Lord President considered that effect (ii) of inhibition allowed it to rank ahead of the charge in *MacMillan*, but could not separate this effect from inhibition being an effectually executed diligence.⁶⁰ He stated that there was “no need” to construct a separate argument regarding diligence not being “effectually executed” but nevertheless rendering the property “litigious”, as was done in *Iona Hotels v Craig*.⁶¹

Lords Drummond Young and Malcolm each presented contrasting views on the issue. The latter perceived s.60 as a “self-contained code” dealing with the ranking of an attached charge against other rights.⁶² Therefore, if inhibition (or another “diligence”) is not effectually executed diligence it cannot prevail against a floating charge. This seems correct when we consider that priority of an inhibitor in a ranking process apparently depends on that party having a real right, such as an actual or constructive adjudication, as would arise in sequestration or liquidation, but not in receivership.⁶³ As stated by Bell: “The inhibitor has not, indeed, without adjudication or other diligence, any active title on which he can demand payment”.⁶⁴ The recognition of inhibition as effectually executed diligence statutorily bypasses the problem as regards receivership, and allows for an inhibitor to make a priority claim to proceeds from a receiver.

⁵⁷ Paras 69-70.

⁵⁸ To varying extents, any statutory “code” of ranking will require interpretation through external references to determine whether something falls within its specified categories.

⁵⁹ The unlikely alternative would be for rights within a particular category to rank *pari passu* due to the lack of specification as to their respective ranking priorities in s.60(1).

⁶⁰ Para 71.

⁶¹ 1990 S.C. 330.

⁶² Para 128.

⁶³ This issue was acknowledged by Lord Malcolm at para 129. And see MacPherson, “In the Twilight Hour?” (2016) 20 EdinLR 353, 359. The Lord President also noted (at para 44) the effect given to inhibition due to sequestration and liquidation but did not consider the implications of this for receivership.

⁶⁴ Bell, *Commentaries*, II, 139.

For inhibition to have any priority in a receivership, it must seemingly fall under the statutory exception provided by the ranking position of “effectually executed diligence”.⁶⁵ This issue was not addressed in Lord Drummond Young’s opinion. He concluded that the circumstances in *MacMillan* were not distinguishable from *Iona Hotels*. Consequently, the inhibitor, even without effectually executed diligence, would have priority over post-inhibition debts, due to the second effect of inhibition.⁶⁶ But the removal of this effect means that this is not the case under the current law.

The possible status of floating charge distribution provisions as a code may, however, have ongoing implications despite the abolition of inhibition’s priority over post-inhibition debts. Whether or not the provisions are a code will determine whether any party not mentioned in one of the listed categories could have a right to payment from a receiver. In addition, the distribution provisions involving floating charges in administration contain no reference to diligence.⁶⁷ If those provisions are a code and diligence does not fit into any of the express categories, then it is problematic for diligence to have any priority over a floating charge attaching in administration. This is discussed further below.

Other Diligences

All common diligences can now be effectually executed diligence., In fact, there seems no reason to automatically exclude any diligence, assuming it is recognised as such. This includes adjudication for debt and the various types of attachment.⁶⁸ The term also extends to arrestment and inhibition on the dependence and interim attachment. (Indeed, the inhibition in *MacMillan* was originally on the dependence of an action.) However, the effectiveness of those diligences in competition with a floating charge will depend on the ultimate success or failure of the related action. A liquidator or receiver would therefore be wise to avoid distributing to such a party until the action is resolved.⁶⁹

Given what has been discussed above, it is not clear how unified the ranking priority of diligences are against a floating charge. It seems that it may be necessary in each case to determine the effects of the relevant diligence and establish how the floating charge fits in with these effects. Diligences that are recognised as judicial real security rights, like adjudication for debt and attachment, will ordinarily rank ahead of a floating charge, whether that charge was created earlier or later. (This is true so long as the diligence in question is valid and became effective before the floating charge’s attachment and is not

⁶⁵ There is the possibility that the *ad hunc effectum* reduction of the floating charge by the inhibitor would mean that the receiver’s appointment is invalid in relation to the inhibitor alone but this would be highly complicated and impractical given that for all other purposes the receiver would be acting as such and would be required to distribute to other parties.

⁶⁶ Para 118. And believed that the Lord Ordinary had made the correct decision given that he needed to consider that *Lord Advocate v RBS* was correctly decided.

⁶⁷ 1986 Act, Sch B1, para 116.

⁶⁸ 2007 Act s.208. For discussion of various diligences, see Gretton, “Diligence”, *SME*; F. Davidson et al, *Commercial Law in Scotland*, 5th edn (2018), ch.8. There are certain diligences like arrestment of earnings and confirmation as an executor-creditor which can only be used against natural persons and, therefore, practically speaking, it is impossible (or at least highly unlikely) that a floating charge could compete with these diligences, as floating charges cannot be granted by natural persons.

⁶⁹ See below for the position regarding administration.

rendered ineffectual due to its proximity to liquidation.) Until a floating charge attaches it does not confer a real right and is subject to pre-attachment real rights,⁷⁰ and diligence, which is the act of a creditor, not the debtor, cannot be prohibited by a negative pledge in the way that the creation of a fixed security right (or floating charge) can be prohibited.

In policy terms, there is a strong case for diligences, including those which have not led to final enforcement against affected property, having priority over a floating charge. The ability to do diligence and obtain a priority is one of the few weapons that an unsecured creditor has in his arsenal. Prioritising diligence over a floating charge acts as something of a corrective to the power and preference given to a chargeholder, who may have security over all of a chargor's assets. A floating charge holder will also generally be well-placed, as a bank or other major lender, to factor in the risk of diligence being done.

Diligence and Corporate Insolvency Processes

Receivership

Although much of the above discussion has involved reference to diligence in receivership, it is necessary to consider further the implications of *MacMillan* in that context. As acknowledged in the case, the circumstances in which a receivership is now available to a chargeholder are much reduced. Yet appointing a receiver remains possible in some circumstances. Creditors with floating charges created before 15 September 2003 are still able to appoint an administrative receiver, as are the holders of certain floating charges created after that date.⁷¹ And a non-administrative receiver can be appointed by a chargeholder with a limited assets floating charge.⁷² The latest available figures show that, despite receiverships decreasing in number, a handful are still taking place each year. In 2017 there were five new receiverships and there were also five the previous year.⁷³ The re-assessment of the relationship between diligence and floating

⁷⁰ Lord Drummond Young at para 89 in *MacMillan*, states that the creation of security rights, including diligence, causes property to “fall outwith the company’s property and undertaking”. This seems incorrect as it would mean that a floating charge could not attach to the property in question, which is not the case. If, for example, the chargor grants another security right, the property still remains attachable by the floating charge, but that floating charge simply ranks behind or ahead of the other security (depending on whether or not there is a negative pledge).

⁷¹ See 1986 Act ss.72B-72GA. These are exceptions to the general prohibition on appointing administrative receivers in s.72A.

⁷² This is because a receiver may be appointed where the floating charge does not attach to the “whole or substantially the whole” of the debtor company’s property: see the combination of 1986 Act ss.51, 72A(3), 251, and Sch B1 para 14.

⁷³ The Insolvency Service, *Insolvency Statistics January to March 2018 Tables*, table 9 (available at <https://www.gov.uk/government/statistics/insolvency-statistics-january-to-march-2018>). Tables 1a and 1d indicate that there were only two insolvency-related receivership appointments in England and Wales in 2017 and 5 in 2016. Figures for Scottish companies are also available from the Accountant in Bankruptcy website, but these differ from the Insolvency Service figures as they correspond to financial years (rather than calendar years) and depend upon the AiB administrative system’s data. According to the AiB figures, only one receiver was appointed in 2017-2018 but three receiverships were commenced in the first quarter of 2018-19 alone: <https://www.aib.gov.uk/scottish-insolvency-statistics-april-june-2018-2018-19-quarter-1>.

charges in *MacMillan* will have continuing significance in new receiverships, as well as for those that are ongoing.

In addition, the meaning given by the court to effectually executed diligence might cause diligence creditors to raise unjustified enrichment actions, if a floating charge holder was enriched at the expense of a diligence creditor in the last five years on the basis of the law as interpreted in *Lord Advocate v RBS*.⁷⁴ This could give rise to problems in continuing receiverships and may lead to the opening up of completed receiverships by virtue of the need for parties to be paid the correct amount due to them (in light of *MacMillan*).⁷⁵ However, Lord Drummond Young in *MacMillan* considered that the possibility of unjustified enrichment actions was not likely to be a major problem. In response to this, it is useful to determine the potential scale of the issue. In the five-year period from 2012 until 2016 inclusive, the statistics show that there were 63 receivership appointments for Scottish-registered companies.⁷⁶ Of course, enrichment events in the five years prior to the decision in *MacMillan* may have taken place in receiverships that began before this period.⁷⁷ Nevertheless, it seems that the fallout in the receivership context will be limited. Diligences including inhibition and arrestment probably featured in a number of the cases, but by no means all of them. And, clearly, as time passes the possibility of challenges diminishes towards zero, and there is nothing (yet) to suggest that *MacMillan* has led to an influx of claims on the basis of unjustified enrichment.

A further point regarding receivership and diligence, but not directly related to *MacMillan*, is that the order of distribution in s.60 of the 1986 Act does not align with relevant ranking rules. If there is a diligence, fixed security and floating charge, and the securities rank in that order,⁷⁸ the distribution provisions oddly require a receiver to pay the fixed security holder before the diligence creditor.⁷⁹ It appears that little care was taken when the distribution rules were formulated. The listed order means there is a potential financial incentive for the fixed security creditor, rather than itself enforcing, to consent to the receiver realising and distributing (as the fixed security holder might then obtain payment before the

⁷⁴ This possibility was recognised by Lord Drummond Young in *MacMillan* at para 114, but he declined to express a view on whether such a claim would be likely to succeed. Obligations based on “redress of unjustified enrichment” are expressly made subject to the five year prescriptive period: Prescription and Limitation (Scotland) Act 1973 s.6 and Sch 1, para 1(b). For discussion see D. Johnston, *Prescription and Limitation*, 2nd edn (2012) paras 6.14-6.20. An unjustified enrichment action can succeed where a payment is made to another party on the basis of an error of law: *Morgan Guaranty Trust Co of New York v Lothian RC* 1995 S.C. 151.

⁷⁵ There are a number of issues involving unjustified enrichment actions, where the actions of a receiver or liquidator have caused the enrichment, which cannot be dealt with here.

⁷⁶ The Insolvency Service, *Insolvency Statistics January to March 2018 Tables*, table 9 (available at <https://www.gov.uk/government/statistics/insolvency-statistics-january-to-march-2018>). The specific figures for the relevant years are: 2012 – 31; 2013 – 18; 2014 – 2; 2015 – 7; 2016 – 5. The final year used here is 2016 as *MacMillan* was decided in early 2017.

⁷⁷ In that earlier period substantially more receiverships were commenced. For example, from 2008 until 2012 inclusive, 186 receiverships were commenced: The Insolvency Service, *Insolvency Statistics January to March 2018 Tables*, table 9 (available at <https://www.gov.uk/government/statistics/insolvency-statistics-january-to-march-2018>).

⁷⁸ This would arise if, for example, the diligence became effective, then the fixed security was created, followed by a floating charge being created (or the floating charge was earlier created but did not have a negative pledge). It is perhaps unlikely that a party would take voluntary security after diligence becomes effective but it is possible.

⁷⁹ This ranking problem is also pointed out by J. St Clair and J. Drummond Young, *The Law of Corporate Insolvency in Scotland*, 4th edn (2011) para 9-18; and Gretton, *Inhibition and Adjudication*, p.219 fn 1. The result is the same under s.60(1) if the fixed security ranks equally with the floating charge.

diligence creditor). This issue and the others involving diligence and receivership are, thankfully, likely to fade from relevance as receiverships become even rarer.

Liquidation

The term “effectually executed diligence” was originally used in the 1961 Act, s.1(2)(a), with reference to the creditors whose rights the floating charge was subject to upon its attachment in liquidation. This formulation was repeated for liquidation in the Companies (Floating Charges and Receivers) (Scotland) Act 1972, s.1(2), and in the currently applicable 1985 Act, s.463(1)(a). Indeed, it is within liquidation that the notion of effectually executed diligence has the most direct relevance, given the application of the 60-day rule. The interpretation of “effectually executed diligence” in *MacMillan* unquestionably applies to the use of that term where floating charges attach in a chargor’s liquidation. If diligence is not rendered ineffectual by virtue of its proximity to liquidation, it will give a priority to the creditor in that process and will (broadly) be treated as a security right, with the liquidator required to make payment to the diligence creditor in accordance with its ranking priority.⁸⁰

The number of Scottish companies entering liquidation each year far exceeds the number of receiverships and administrations. In 2016 alone, there were 589 compulsory liquidations and 285 creditors’ voluntary liquidations.⁸¹ Similar to the position for receivership, if a liquidator distributed to a floating charge holder ahead of an arrester or an inhibitor, on the basis of *Lord Advocate v RBS*, then the diligence creditor would have five years to make a claim in unjustified enrichment to receive the money due to them. If any purported diligence creditor received money from a liquidator, whether as a compromise payment or otherwise, it is likely that they will be precluded from making a claim if it was agreed that the payment was made in full and final settlement of the creditor’s claims against the debtor. In any event, the impact of *MacMillan* in terms of interfering with concluded or ongoing liquidations is likely to be restricted and manageable. Unlike with receivership, which depends on the existence of a floating charge, many liquidations do not feature floating charges. And an even smaller percentage of liquidations involve both a floating charge and diligence of a type that is affected by the overturning of *Lord Advocate v RBS*.

Administration

The principal method of enforcing a floating charge is now through the appointment of an administrator. Unfortunately, the relationship between administration and diligence is uncertain. This remains the case

⁸⁰ See e.g. *Liquidators of the Benbar Coal Co v Turnbull* (1883) 10 R. 558; *Granite Properties v City of Edinburgh Council* 2002 S.L.T. (Sh. Ct.) 79; D. McKenzie Skene, *Insolvency Law in Scotland* (1999), pp.258-260. See also *Commercial Aluminium Windows v Cumbernauld Development Corp* 1987 S.L.T. (Sh. Ct.) 91; *Customs and Excise Commissioners v John D Reid Joinery Ltd* 2001 S.L.T. 588; H. Goudy, *A Treatise on the Law of Bankruptcy in Scotland*, 2nd edn (1895), p.197.

⁸¹ The Insolvency Service, *Insolvency Statistics January to March 2018 Tables*, table 9 (available at <https://www.gov.uk/government/statistics/insolvency-statistics-january-to-march-2018>). In a members’ voluntary liquidation the company will be solvent and so all creditors can be paid in full.

despite *MacMillan* and it is also a potentially widespread issue given the volume of administrations of Scottish companies: for example, there were 85 new administrations in 2017 and 145 the previous year.⁸²

Unlike for receivership and liquidation, there is no mention of “effectually executed diligence” in the administration provisions. In fact, the only reference to diligence is within the context of the administration moratorium. The 1986 Act, Schedule B1, para 43(6), provides that:

“No legal process (including legal proceedings, execution, distress and diligence) may be instituted or continued against the company or property of the company except – (a) with the consent of the administrator, or (b) with the permission of the court.”

It is clear that a creditor cannot, without consent or permission, execute diligence or proceed to the next stage of diligence (such as a forthcoming following arrestment) during the administration. One specific point that is not certain is whether the moratorium includes the automatic release of funds following an arrestment, where the 14-week release period started prior to the administration.⁸³ If this is deemed a continuation of diligence then it will be caught; however, the provision may be limited to positive actions by (purported) creditors after the commencement of administration and will therefore not apply to an automatic process that requires no active involvement by the creditor. The outcome could well be different if a valid objection is raised within the automatic release process, but it is not immediately apparent what the basis of an administrator’s objection would be.⁸⁴

More broadly, there are at least four possibilities regarding the status of diligence in an administration:

- (1) diligence is rendered wholly invalid (“invalidity approach”);
- (2) diligence is suspended during the administration but is reactivated when the company leaves administration, assuming that the property subject to the diligence has not been realised or otherwise disposed of (“suspension approach”);
- (3) diligence is treated as a security right, or at least certain types of diligence are treated this way (“security approach”); and
- (4) diligence continues to have effect separately from the administration regime, therefore an administrator has to take account of diligence when disposing of affected property and/or distributing proceeds (“separate effect approach”).

The invalidity approach would lead to quite extraordinary results. A diligence that had existed for some period of time, perhaps months, or even years, would be wiped out. Such an extreme outcome is highly

⁸² The Insolvency Service, *Insolvency Statistics January to March 2018 Tables*, table 9 (available at <https://www.gov.uk/government/statistics/insolvency-statistics-january-to-march-2018>).

⁸³ For details of the automatic release of arrested funds, see Debtors (Scotland) Act 1987 ss.73J-73T.

⁸⁴ See Debtors (Scotland) Act 1987 s.73M(4) for the grounds of objection.

objectionable in policy terms and would undermine one of the principal remedies available to unsecured creditors.⁸⁵ It must be rejected. The suspension approach is only marginally better. An administrator might be expected to resort to disposing of property subject to diligence, as this would free up more proceeds for other creditors, which again undermines the role of diligence.

With reference to the security approach, the term “security” is used in para 43(2) as regards the moratorium on enforcement, while diligence is expressly and separately included as a “legal process” in the administration moratorium context.⁸⁶ This suggests that “security” here does not include diligence. An alternative view is that diligence *does* fall within the meaning of security and its express inclusion as a legal process was a way to avoid doubt regarding its dual status. There is also some uncertainty as to whether diligence is contained within the general definition of “security” in the 1986 Act, s.248(b)(ii). Professor Wilson argues that diligence is probably not such a security, unless it is a “preference” within that definition.⁸⁷ Yet diligence *is* broadly viewed as one category of security in Scots law (judicial security)⁸⁸ and *is* treated as a security in certain areas of corporate insolvency.⁸⁹ The standing of diligence in corporate insolvency is, nevertheless, an example of a perennial problem for Scots law: determining what constitutes a security in particular contexts.⁹⁰ One of the consequences of diligence being deemed a security in administration would be that the property could not be sold by the administrator except with the consent of the court.⁹¹ If the property was sold with the court’s consent, the diligence creditor would be entitled to payment of proceeds in accordance with its ranking priority.⁹²

There is also uncertainty as to whether diligence’s suggested status as a security in administration is uniform or piecemeal. Professor Gretton, for example, contends that adjudication is “presumably” a security in administration, while inhibition is probably not.⁹³ As Gretton notes, there would be an odd result if inhibition was a security: inhibition on the dependence would entitle the inhibitor to payment from an administrator if inhibited property was sold, even if the action related to the inhibition was later unsuccessful. However, the same is true of arrestment (on the dependence)⁹⁴ and interim attachment. Adopting a piecemeal security approach might therefore mean that adjudication is the only diligence

⁸⁵ The removal of a diligence creditor’s property interest might also require specific valid justification to avoid being contrary to the protection of property under Article 1 of the First Protocol to the European Convention on Human Rights.

⁸⁶ In Sch B1, para 43(6).

⁸⁷ W.A. Wilson, *The Scottish Law of Debt*, 2nd edn (1991), para 26.12. The status of diligence as a “preference” is plausible when we consider that no arrestment or attachment within 60 days of sequestration or liquidation is “effectual to create a preference”: 2016 Act s 24(6), as applied to liquidation by the 1986 Act s.185(1)(a).

⁸⁸ See e.g. the tripartite division of security rights in Bell, *Commentaries*, II, 10.

⁸⁹ For example, a liquidator is required to distribute to a diligence creditor ahead of other creditors under Insolvency (Scotland) Rules 1986/1915 r.4.66, including through recognising a diligence creditor as a secured creditor under r.4.66(6)(a).

⁹⁰ See 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); and see now also MacLeod, “Thirty Years After: The Concept of Security Revisited” in *Nothing so Practical as a Good Theory: Festschrift for George L. Gretton* (2017).

⁹¹ 1986 Act Sch B1 para 71(1)-(2).

⁹² 1986 Act Sch B1 para 71(3)-(4).

⁹³ Gretton, *Inhibition and Adjudication*, 180-181 and 223. He is referring to the pre-Enterprise Act 2002 regime of administration orders, but this does not seem to affect the analysis.

⁹⁴ See Gretton, “Diligence”, *SME*, para 296.

recognised as a security in administration, as it would seem strange if the judicial security of attachment is also considered a security while interim attachment is not. In general terms, it would be unfair for those with interim forms of diligence (including diligence on the dependence) to be treated less favourably here than those with non-interim versions of those diligences. An interim diligence is intended to protect a creditor who may ultimately succeed with his action. Given the uncertainty, an administrator should be hesitant about seeking to realise any property that is subject to diligence on the dependence or interim attachment.

Even if diligences are not securities within the administration regime, it has been suggested that an administrator will nevertheless be affected by them in his dealings with the property.⁹⁵ According to this separate effect approach, property encumbered by diligence will remain subject to that diligence unless the diligence creditor receives payment of sums due to him or otherwise consents to the transfer. There is no equivalent process by which a court can give permission for a transfer free of encumbrance, as there is if diligence is considered a security right.⁹⁶ Thus, unless the diligence creditor consented, a transferee would obtain property burdened by the diligence. This approach is particularly favourable for diligence creditors. It also generally fits administration into Scots law better than considering that an administrator can dispose of property free from diligence. Yet the absence of any express limitation on an administrator's powers relating to diligence is a problem with this construction, especially when we consider that there was considered a need to make a receiver's powers *expressly* subject to the rights of those with effectually executed diligence.

The uncertain status of diligence in administration also extends to its ranking relationship with floating charges. A floating charge can attach during an administration and, if it does, the administrator must comply with a distribution list for proceeds.⁹⁷ The list is a broad equivalent of the receivership version and includes a number of the same categories, such as the holders of "fixed securities" ranking prior to, or *pari passu* with, the floating charge, and "preferential creditors". One major difference is that there is no mention of diligence in the administration version. The term "fixed security", which is used elsewhere in the 1986 Act, including for receivership in s.60, apparently excludes diligence, as "diligence" is included within the separate concept of "effectually executed diligence". It would therefore be peculiar if "fixed security" in the 1986 Act, Sch B1, para 116, extended to diligence. The obvious conclusion is that the administrator has no duty to distribute proceeds to a diligence creditor under the provision.⁹⁸ But if the

⁹⁵ See e.g. Gretton, *Inhibition and Adjudication*, 180-181; Wilson, *Debt*, para 26.12. If diligence is still valid despite administration, it would be advantageous to diligence creditors for the company to go into administration rather than liquidation. This is because administration does not render recently executed diligences ineffectual.

⁹⁶ See D. McKenzie Skene, "Corporate Insolvency", in *The Laws of Scotland: Stair Memorial Encyclopaedia* (Reissue) (2008), para 90.

⁹⁷ 1986 Act Sch B1, para 116. This form of attachment is understood to be relatively rare. The general distribution rules for administrators align with those for liquidators (Insolvency (Scotland) Rules 1986/1915 r.2.41) but it is presumed that these are subject to Sch B1, para 116, where there is an attached floating charge.

⁹⁸ The administration distribution provisions are obscure in other respects. For example, if there is a floating charge with negative pledge, a fixed security and a second floating charge, and they all rank in that order, 1986 Act Sch B1, para 116(e) and (f), could be interpreted as providing that the holders of both attached floating charges should receive payment before the fixed security holder.

separate effect approach applies, then a diligence creditor may actually be in a stronger position than if they were on the list. If property transferred by an administrator remains subject to diligence, this could give a diligence creditor leverage to demand payment before other parties or to refuse to give consent to realisation of the property.⁹⁹ Conferring this status upon diligence without express statutory provision in administration (which is a statutory process) may be questionable, especially due to the distribution list's potential status as a code,¹⁰⁰ and could interfere with the administrator's attempts to achieve the purpose of an administration. Anecdotal evidence suggests that administrators currently have no fixed view on the status of diligence but often consider it to be of sufficient significance, or the law to be inadequately clear, that they will pragmatically engage in negotiations with the creditor to reach an agreement and thereby enable the administration to progress.

Recognising the continued relevance of diligence in administration is desirable, but the extent to which this is presently achieved, and how, is opaque. It may be that because administration was originally conceived as a rescue procedure only, there was no perceived need to make specific provision for the rights of diligence creditors. Any diligence would simply be frozen for the duration of the process and would be reactivated upon the company exiting administration. Yet the potential for administration to also be a distributive process requires a rethink of how diligence is dealt with in administration. The current position is unenviable and could be addressed by a legislative statement within Schedule B1 of the 1986 Act. It might be provided that diligence is a security right and a diligence creditor is to receive priority in accordance with its relative ranking priority against other security rights, when an administrator realises affected property and distributes proceeds. Alternatively, and preferably, particular provision could be made for diligence creditors as a category, including specification that the ranking priority of diligence in a distribution will be in accordance with the general law. And an entry for effectually executed diligence could be inserted into the administration distribution provisions involving an attached floating charge.¹⁰¹ It would be useful if these proposed changes were accompanied by a provision requiring proceeds potentially due to creditors with diligence on the dependence and interim attachment to be held by an administrator until the outcome of those creditors' actions are known.

Further Ranking Issues

Certain ranking issues involving floating charges and diligence have already been mentioned but there are various others that are unresolved, or which are compounded by the decision in *MacMillan*. It is true that *MacMillan* removes the possibility of a circle of priority involving an arrestment, assignation and an attaching

⁹⁹ This may be supported too by the administrator's status as agent of the company in exercising his functions (1986 Act Sch B1, para 69), so that the administrator dealing with property could be deemed equivalent to the company dealing with it.

¹⁰⁰ It also raises questions about the value of the distribution list if a party does not have to be on it in order to have priority and increases uncertainty as to which parties may have a preference over those on the list.

¹⁰¹ Care would need to be taken to make sure that fixed securities and diligences are listed in their ranking order. Cf the alternative order for receivership distributions in the 1986 Act s.60(1) noted above.

floating charge.¹⁰² But it can be questioned whether the floating charge in the scenario would have attached to the property anyway, as an assignation with intimation is a transfer and would mean that the property would no longer be part of the company's property and undertaking.¹⁰³ If a floating charge could attach to property assigned *in security*, the circle was unlikely to arise in practice as it was predicated on a floating charge not having a negative pledge and in almost all cases a negative pledge exists.¹⁰⁴

Another circle of priority involving diligence and floating charges already exists in Scots law. Let us take the following sequence of events: (i) A Ltd grants a floating charge with negative pledge over all of its property and undertaking to B; (ii) A Ltd grants a fixed security (e.g. a standard security) over a piece of property to C; (iii) D, a creditor of A Ltd, does diligence (e.g. an adjudication for debt)¹⁰⁵ over the same property; and (iv) B's floating charge attaches. The result is that B has priority over C due to the negative pledge,¹⁰⁶ C ranks ahead of D due to the application of *prior tempore potior jure*, and D ranks before B because D has effectually executed diligence.¹⁰⁷ The decision in *MacMillan* has not created this circularity; however, it may increase the circumstances in which it materialises. For example, if the fixed security in the example above is an assignation in security and the diligence is an arrestment, the circularity could appear following *MacMillan*. However, this is dependent upon the floating charge being able to attach to property assigned in security.¹⁰⁸ If the "statutory pledge" proposed by the Scottish Law Commission ("SLC") is introduced, and ranks ahead of subsequent diligences (as is currently proposed), in contrast to the floating charge, this would also allow for the circle of priority to arise.¹⁰⁹

In addition, the rules on equalisation of diligences also create ranking issues when a floating charge is involved. If two adjudications are within a year and a day of one another, they rank equally, but what is the ranking order if a floating charge attaches¹¹⁰ in the period after the first adjudication becomes effective but before the second one does so?¹¹¹ Even more complicated is the question of ranking where there is a valid floating charge, then some time later diligence (attachment or arrestment) is executed, an apparent

¹⁰² For which, see Wortley, "Squaring the Circle" 2000 Jur. Rev. 325.

¹⁰³ See A.D.J. MacPherson, "The Attachment of the Floating Charge in Scots Law" (PhD Thesis, University of Edinburgh) (2017), 236-237.

¹⁰⁴ If it did have a negative pledge it would have ranked ahead of a later fixed security, meaning the charge (being enforced through the receiver) would rank first, then the arrestment, then the assignation in security.

¹⁰⁵ The same would apply to land attachments if they were to be introduced: see Part 4 of the 2007 Act.

¹⁰⁶ 1985 Act s.464(1)(a) and (1A).

¹⁰⁷ See 1985 Act s.463(1)(a) for liquidation and 1986 Act s.60(1)(b) for receivership.

¹⁰⁸ See MacPherson, "The Attachment of the Floating Charge in Scots Law", ch 9.

¹⁰⁹ See A. MacPherson, "The Future of Moveable Security in Scots Law? Comments on the Scottish Law Commission's Report on Moveable Transactions" 2018 Jur. Rev. 98. And consider the post-*MacMillan* position involving a floating charge without negative pledge, a later inhibition, and then a fixed security, in a liquidation scenario: the floating charge is (apparently) not affected by the later inhibition, but the inhibitor has priority over the fixed security, which has priority over the floating charge (assuming the fixed security is created before the floating charge attaches). See also, Wortley, "Squaring the Circle" 2000 Jur. Rev. 325, 346, and Stewart, *Diligence*, pp.145-146.

¹¹⁰ By virtue of receivership. Administration and liquidation will preclude an effective second adjudication. If diligence continues to affect property despite administration, then administration is more favourable to a diligence creditor than liquidation as the passing of time in administration will remove the possibility of equalisation and ineffectiveness of diligence.

¹¹¹ See Gretton, *Inhibition and Adjudication*, pp.223-224.

insolvency event¹¹² takes place within 60 days of the diligence becoming effective, and this apparent insolvency is followed by liquidation of the debtor within four months. In these circumstances, the diligence is equalised with the claims of unsecured creditors;¹¹³ however, the diligence may still be “effectually executed” (as it is not actually cut down by the 60-day rule). The diligence has priority over the floating charge, which prevails over unsecured creditors, but these creditors rank equally with the diligence. Perhaps the diligence will be deemed not to be effectually executed diligence (in part) to avoid this difficulty.

(In)compatibility?

It has been a consistent theme of judgments relating to the Scottish floating charge to refer to the charge’s “alien” nature. Lord Drummond Young’s opinion in *MacMillan* followed this course while providing the strongest criticism of the floating charge in Scots law for some time. He noted that the floating charge in England has caused difficulties in corporate insolvency, despite the existence of equity, the charge’s natural habitat.¹¹⁴ There were inevitably problems translating, by statute, an equitable construct into the Civilian system of Scots property law and this became obvious in relation to the charge’s relationship with diligence, for which there is no exact equivalent in English law.¹¹⁵ It is certainly true that the floating charge and diligence have endured a difficult relationship, but blame cannot only be apportioned to the transplant of the floating charge into Scots law. Although the floating charges legislation could have more clearly outlined the meaning of effectually executed diligence, the saga also highlights that there is considerable uncertainty, difference and fragmentation across the “indigenous” law of diligence, which means there are problems incorporating that law into legislation. As shown above, the issues involving diligence have also spread beyond its interaction with floating charges into the broader field of corporate insolvency, most notably in the context of administration.

In *MacMillan*, Lord Drummond Young also pointed out the Common Law trend “towards the systematic codification of property and security rights”¹¹⁶ as typified by Article 9 of the Uniform Commercial Code (USA) and Personal Property Security Acts (in places like Australia, New Zealand and Canada). He praised the systematisation and publicity (through registration) inherent in these approaches and contrasted this with the incoherence and uncertainty offered by the floating charge since its introduction. The SLC’s project on Moveable Transactions was welcomed by Lord Drummond Young; however, the recommendations in the SLC’s Report do not go as far as his Lordship would like. The SLC

¹¹² The apparent insolvency events are outlined in s.16 of the Bankruptcy (Scotland) Act 2016. There is some debate as to whether administration is an apparent insolvency event, see e.g. Wilson, *Debt*, para 26.12; St Clair and Drummond Young, *Corporate Insolvency*, para 9.12; McKenzie Skene, *Insolvency Law*, p.255.

¹¹³ Bankruptcy (Scotland) Act 2016 Sch.7 para.1(1) and 1(6); *Clark v Hinde, Milne & Co.* (1884) 12 R. 347; *Stewart v Jarvie*, 1938 S.C. 309. A similar outcome arises if adjudication is followed by liquidation within a year and a day.

¹¹⁴ Para 76.

¹¹⁵ Paras 76 and 121. The rights obtained by execution creditors in English law can approximate those of diligence creditors in certain respects but execution does not generally have the same status as diligence as regards property law or insolvency law, including in competition with a floating charge. For execution creditors in English law, see e.g. A.R. Keay and P. Walton, *Insolvency Law: Corporate and Personal*, 4th edn (2017), ch 33.

¹¹⁶ Para 122.

have not proposed to adopt a functionalist system of security interests on the UCC-9/PPSA model.¹¹⁷ Certainly, the new proposed “statutory pledge” would interact with diligence in a way more in-keeping with the general law. But the floating charge will remain in existence and there may be ranking difficulties involving this security, diligence and the floating charge, as identified above.

Conclusion

The First Division in *MacMillan* deserves credit for boldly overturning *Lord Advocate v RBS* 40 years on. The saga involving diligence and floating charges has highlighted some of the difficulties integrating the floating charge into wider Scots law as well as problems with the charges legislation, but these have been exacerbated by previous judicial decision-making and a lack of clarity regarding the law of diligence. *MacMillan* has solved certain aspects of the interaction between floating charges and diligence, but particular doubts persist. The nature of arrestment has not been definitively determined, the precise effect of an inhibition in various insolvency contexts is still uncertain and there are ongoing problems involving the ranking of diligence and floating charges. Even beyond the direct relationship between diligence and the floating charge, the status of diligence in administration is unclear and unsatisfactory. Overall, there has been a lack of joined-up thinking across the laws of floating charges, diligence and corporate insolvency. It is perhaps too pessimistic to suggest that the floating charge is fundamentally incompatible with diligence; however, their interaction continues to be problematic despite the *MacMillan* decision.

It is unlikely that case law by itself can resolve the problems outlined in this article. There is no certainty as to when a relevant issue will arise before a court and any decisions emerging in that forum will be piecemeal in addressing the difficulties in this area of law. The current legal position may even be minimising the likelihood of further cases, by causing insolvency practitioners to seek negotiated agreements with creditors rather than becoming involved in litigation in the courts, with its significant expense and time implications. It would be more appropriate for there to be an overarching examination of the interaction between diligence and corporate insolvency law including floating charges (and perhaps also extending to sequestration) followed by appropriate legislation. It is not possible to outline detailed solutions here but some broad comments can be made regarding possible mechanisms for reform.

The Accountant in Bankruptcy has been conducting a review of the law of diligence¹¹⁸ and this could be extended to include at least some matters raised in the present article. However, that review is at a relatively advanced point and has (largely) avoided the interaction between diligence and insolvency. There are also complications arising from the fact that such interaction involves both devolved and reserved

¹¹⁷ See Scottish Law Commission, *Report on Moveable Transactions* (Scot Law Com No 249) (2017), especially ch 18, for more details.

¹¹⁸ See Accountant in Bankruptcy, *Diligence Consultation 2016: The Report of the Summary of Responses and the Response from Accountant in Bankruptcy* (2018), available at: https://www.aib.gov.uk/sites/default/files/accountant_in_bankruptcy_aib_-_diligence_review_2016_consultation_response_0.pdf (accessed 11 September 2018).

matters.¹¹⁹ For corporate insolvency law, the awaited Insolvency Rules for Scotland are a potential source of reform but these are unlikely to remedy the problems discussed above¹²⁰ and will be limited in what they can achieve by virtue of their status as secondary legislation. The relationship between diligence, floating charges and corporate insolvency would no doubt benefit from exposure to a Scottish Law Commission project. Such an endeavour would necessitate the input of the legal profession and insolvency practitioners and could provide a forum for other interested parties. Although much work would be required to make the relevant law coherent, doing so is both achievable and desirable.

¹¹⁹ See Scotland Act 1998 ss.29(2)(b), 30(1) and Sch 5, Head C2.

¹²⁰ And there is little chance of the Rules being specifically extended to deal with the issues outlined in this article at such a late stage.