

FUND FINANCE FRIDAY

Scottish Limited Partnerships – Security Reforms for Funds

June 9, 2023



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Scottish limited partnerships are often used in fund structures. They are very flexible, with little restriction on the terms of their partnership agreements and few specific constitutional requirements. They are quick and easy to set up, with relatively low ongoing administration requirements. They are general business organisations from a G7 country that have been used in many other sectors too since 1907. Most importantly, they have separate legal personality from their partners and tax transparency in the UK and many other jurisdictions. It is therefore very common to see them used as feeder funds, carried interest entities, general partners and performing other fund management functions as well as being used as vehicles directly holding investments of various types.

When funds use subscription line or NAV facilities or co-investment, general partner or other management facilities are put in place, it accordingly becomes necessary to take security interests over various rights related to Scottish limited partnerships that may be part of a given fund structure. As those who have done so will be aware, this can sometimes be less than straightforward, due to the old-fashioned nature of the relevant Scots law of assignation (assignment) and security. These complications should become largely a thing of the past thanks to the passage of the Moveable Transactions (Scotland) Bill (the “Bill”). The Bill was passed by the Scottish Parliament on 4 May 2023 and is expected to come into force in the second half of 2024.

Current security over Scottish commitments and distributions

Security for these types of facilities normally includes either security over commitments of limited partners to advance funds to the Scottish limited partnership, or over distribution rights of partners due from the limited partnership. This security takes the form of an assignment in security by the limited partnership of commitment rights or by the partners of distribution rights, with those rights deriving from the limited partnership agreement. Under current Scots law there are three areas which can cause difficulties in practice when taking such security:

1. an assignment has no proprietary effect until notice has been given to the relevant counterparty.
2. retention of control of the rights assigned by the assignor may undermine the assignment (and thereby the security created); and
3. there are currently serious doubts about the effectiveness of an assignment of rights that do not exist at the time of assignment.

While a number of these issues can arise in relation to security assignments of distribution rights, they arise on a regular basis in relation to security assignments of commitment rights.

Giving notice

While giving notice to limited partners of security assignments of commitments is not normally a problem in principle, the current safest means of giving notice under Scots law is by posting a certified copy of the assignment to the limited partners (to comply with current legislative requirements dating from 1862). Otherwise acknowledgement by limited partners or a high degree of certainty that they have received and are aware of the effect of the notice is required and giving notice by email and through online portals to large numbers of limited partners currently gives rise to administrative headaches. Back-up notices served by post often continue to be used.

Control

An assignee of commitment rights must currently control their exercise otherwise the assignment (and thereby the security created) could be challengeable. Depending on management and lender convenience, drawdown notices may be countersigned by lenders or sent to lenders before issue with an opportunity to divert funds drawn, which may, in turn, require to be paid into a blocked bank account controlled by the lender. These mechanisms can cause some administrative burden.

Future rights

In addition, as commitments from new limited partners and increases in commitments of initial limited partners will not exist at the time an initial security assignment is taken, security assignments normally make provision for supplemental assignments to be taken when new limited partners are admitted or commitments are increased or transferred. This can be complex when a fund has multiple closings and the triggers and their timings can also be missed, leading to technical defaults by funds.

Most of these issues will be addressed when the reforms under the Bill come into force.

The new Scottish regime

The reforms are not unlike a personal property security act, although they do not provide for recharacterisation of transactions and documents rather than notices are filed. The law of assignment of “claims” (*i.e.*, rights) is modernised under the reforms and a new “statutory pledge” is introduced over tangible moveables, intellectual property and further intangibles that may be specified by secondary legislation. The legislation will also create a new online public Register of Assignations and corresponding Register of Statutory Pledges, both operated by Registers of Scotland, the main Scottish public registration entity. While it is anticipated that the statutory pledge regime will be extended to cover shares and other financial instruments when it comes into force, it may not be applicable in the short term to create security over fund commitment or distribution rights.

Assignations under the new Scottish regime

Given the broad definition of “claim” in the Bill, security assignations of both fund commitment and distribution rights will fall within the ambit of the reforms.

It will be possible under the new regime to dispense with notice to limited partners and other counterparties by instead registering an assignment document online in the new Register of Assignations and for this assignment document to cross refer to relevant data (such as limited partner details). In the alternative, modernised notice provisions in the new legislation will facilitate electronic notice to effect the assignment instead of doing so by registering the assignment document in the Register of Assignations (and notice may in any event be given at any time to ensure that payment to the assignor does not discharge the claim assigned if an assignment document is uploaded). This will address issue 1 (Giving Notice) outlined above.

The Bill also clarifies that an assignment document can assign future claims with effect from them coming into existence and that payment to an assignor will not undermine an assignment. Current mechanisms under which supplemental assignments require to be taken in relation to new partners and increased or transferred commitments will no longer be necessary. Likewise current mechanisms involving lenders in drawdown notices or blocking drawdown receipts accounts will cease to be necessary. This will address issues 2 (Control) and 3 (Future rights) outlined above.

Statutory pledges under the new Scottish regime

As indicated above, the new statutory pledge regime is unlikely initially to be applicable to security over Scottish partnership commitment or distribution rights, although if given partnership interests constitute “securities equivalent to shares in companies” (and thus “financial instruments” for the purposes of the Financial Collateral Arrangements (No.2) Regulations 2003), those partnership interests may be included when, as anticipated, financial instruments are added to the statutory pledges regime when the reforms come into force. Currently, only distribution or other restricted rights under Scottish partnership agreements are assigned in security in order to reduce the risk of the security holder becoming a partner (and in particular a general partner with liability for partnership obligations). It would be useful to clarify that Scottish partnership interests are to be included when shares and other financial instruments are added to the statutory pledge regime so that fixed security can be taken safely over those full interests rather than over more restricted rights.

Conclusions

The reforms under the Bill are very broad, and will greatly simplify a number of areas of Scots finance law, from receivables finance, securitisation, asset finance, real estate finance, technology finance, project finance and many others. While further work is required to ensure the statutory pledge regime also applies in funds finance, the reforms (and in particular the assignation reforms) will be very welcome in simplifying the execution of funds finance transactions involving Scottish limited partnerships, and the Shepherd and Wedderburn team has been very pleased to have been involved over a number of years in bringing them to fruition.

For further information on the reforms brought about by the Bill, please see the [Shepherd and Wedderburn moveable transactions landing page](#).