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Terminology and recommendations of the UNCITRAL draft Legislative Guide on Secured Transactions

Note by the Secretariat

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Terminology

[*Note to the Commission: The Commission may wish to note that the terminology will be placed in section B of the Introduction of the final text of the Guide, while recommendations will appear after the commentary in each chapter. The terminology is reproduced in this document with the recommendations for ease of reference. The Commission may wish to consider whether the terminology and recommendations should also be reproduced in a separate appendix to the Guide in its final version.*]

1. The Guide adopts terminology to express the concepts that underlie an effective secured transactions regime. The terms used are not drawn from any particular legal system. Even when a term appears to be the same as that found in a particular national law (whether secured transactions or any other law), the Guide does not intend to adopt the meaning of the term in that national law. Rather, the Guide provides definitions giving a specific meaning to each key term in order to facilitate precise communication, independent of any particular national legal system, and to enable readers of the Guide to understand its recommendations in a uniform way, providing them with a common vocabulary and conceptual framework.

2. Some recommendations use terms that are defined in those recommendations, while the meaning of some terms defined below is further elaborated in recommendations that use those terms or specific chapters of the Guide. The scope and content of each recommendation depends on the meaning of its defined terms. Thus, legislators may consider using the definitions in order to avoid unintended substantive changes, maximize uniform interpretation of the new legislation and promote harmonization of secured transactions law.

3. The word “or” is not intended to be exclusive; use of the singular also includes the plural and vice versa; “include” and “including” are not intended to indicate an exhaustive list; “may” indicates permission and “should” indicates instruction; and “such as” and “for example” are to be interpreted in the same manner as “include” or “including”. “Creditors” should be interpreted as including both the creditors in the enacting State and foreign creditors, unless otherwise specified. References to “person” should be interpreted as including both natural and legal persons, unless otherwise specified.

4. Some States may choose to implement the recommendations of the Guide by enacting a single comprehensive statute (a method more likely to produce coherence and avoid errors of omission or misunderstanding), while other States may seek to modify their existing body of law by insertion of specific rules in various statutes. The Guide refers to the entire body of recommended rules, whichever method is chosen for implementation, as “the law” or “this law”.

5. The Guide also uses the term “law” in various other contexts. Except when otherwise expressly provided, throughout the Guide: (a) all references to law refer to both statutory and non-statutory law; (b) all references to law refer to domestic law, excluding conflict-of-laws rules (so as to avoid renvoi); (c) all references to “other law” refer to the entire body of a State’s law (whether substantive or procedural) other than that embodying the law governing secured transactions (whether pre-existing or newly enacted or modified pursuant to the

recommendations of the Guide); (d) all references to "the law governing negotiable instruments" refer not only to a special statute or body of law denominated as "negotiable instruments law" but include also all contract and other general law that might be applicable to transactions or situations involving a negotiable instrument (the same rule applies to similar expressions); and (e) all references to "insolvency law" are similarly all-encompassing, but refer only to law that might be applicable after the commencement of insolvency proceedings.

6. The following subparagraphs identify the principal terms used and the core meaning given to them in the Guide. The meaning of these terms is further refined when they are used in subsequent chapters. Those chapters also define and use additional terms (as is the case, for example, with chapter XIV on the impact of insolvency on a security right). The definitions should be read together with the relevant recommendations. The principal terms are defined as follows:

(a) "Acknowledgement" with respect to a right to receive the proceeds under an independent undertaking means that the guarantor/issuer, confirmer or nominated person that will pay or otherwise give value upon a demand for payment ("draw") under an independent undertaking has, unilaterally or by agreement:

(i) Acknowledged or consented to (however acknowledgement or consent is evidenced) the creation of a security right (whether denominated as an assignment or otherwise) in favour of the secured creditor in the right to receive the proceeds under an independent undertaking; or

(ii) Has obligated itself to pay or give value to the secured creditor upon a draw under an independent undertaking;

(b) "Acquisition secured creditor" (a term used in the context of both the unitary and the non-unitary approaches to acquisition financing) means a secured creditor that has an acquisition security right. In the context of the unitary approach, the term includes a retention-of-title seller or financial lessor (terms used in the context of the non-unitary approach);

(c) "Acquisition security right" (a term used in the context of both the unitary and the non-unitary approaches to acquisition financing) means a security right in a tangible asset (other than a negotiable instrument or negotiable document) that secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire the asset. An acquisition security right need not be denominated as such. Under the unitary approach, the term includes a right that is a retention-of-title right or a financial lease right (terms used in the context of the non-unitary approach);

(d) "Assignee" means the person to which an assignment of a receivable is made;[1]

(e) "Assignment" means the creation of a security right in a receivable that secures the payment or other performance of an obligation. While an assignment that is an outright transfer does not secure the payment or other performance of an

[1] For the definitions of the terms "assignee", "assignor" and "assignment", see article 2, subparagraph (a), of the United Nations Convention on the Assignment of Receivables in International Trade (United Nations publication, Sales No. E.04.V.14; hereinafter referred to as "the United Nations Assignment Convention").

obligation, for convenience of reference, the term also includes an outright transfer of a receivable;[2]

(f) "Assignor" means the person that makes an assignment of a receivable;

(g) "Attachment to immovable property" means a tangible asset that is so physically attached to immovable property that, despite the fact that it has not lost its separate identity, is treated as immovable property under the law of the State where the immovable property is located;

(h) "Attachment to movable property" means a tangible asset that is physically attached to another tangible asset but has not lost its separate identity;

(i) "Bank account" means an account maintained by a bank to which funds may be credited. The term includes a checking or other current account, as well as a savings or time deposit account. The term does not include a right against the bank to payment evidenced by a negotiable instrument;

The term also includes a right to the payment of funds transferred to the bank by way of anticipatory reimbursement of a future payment obligation to which the bank has committed and a right to the payment of funds transferred to the bank by way of cash collateral securing an obligation owed to the bank to the extent that the transferor of those funds has a claim to them, if under national law the bank's obligation is a bank account.

(j) "Competing claimant"[3] means a creditor of a grantor competing with another creditor that has a security right in an encumbered asset of the grantor and includes:

(i) Another secured creditor with a security right in the same encumbered asset (whether as an original encumbered asset or proceeds);

(ii) In the context of the non-unitary approach to acquisition financing, the seller, financial lessor or other acquisition financier of the same encumbered asset that has retained title to it;

(iii) Another creditor of the grantor that has a right in the same encumbered asset;

(iv) The insolvency representative in the insolvency of the grantor;[4] or

(v) Any buyer or other transferee (including a lessee or licensee) of the encumbered asset;

(k) "Confirmer" means a bank or other person that adds its own independent undertaking to that of a guarantor/issuer;

In line with article 6, subparagraph (e), of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit[5] (hereinafter referred to

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[2] See the definition of "security right", as well as recommendation 3 and related commentary.

[3] For the definition of the term "competing claimant", see article 5, subparagraph (m), of the United Nations Assignment Convention.

[4] In the chapter on insolvency, reference is made to "the insolvency of the debtor" for reasons of consistency with the terminology used in the UNCITRAL Legislative Guide on Insolvency Law (United Nations publication, Sales No. E.05.V.10; hereinafter referred to as "the UNCITRAL Insolvency Guide").

as "the United Nations Guarantee and Stand-by Convention"), a confirmation provides the beneficiary with the option of demanding payment from the confirmer in conformity with the terms and conditions of the confirmed independent undertaking instead of from the guarantor/issuer;

(l) "Consumer goods" means goods that the grantor uses or intends to use for personal, family or household purposes;

(m) "Control" with respect to a right to receive the proceeds under an independent undertaking exists:

(i) Automatically upon the creation of the security right if the guarantor/issuer, confirmer or nominated person is the secured creditor; or

(ii) If the guarantor/issuer, confirmer or nominated person has made an acknowledgment in favour of the secured creditor;

(n) "Control" with respect to a right to payment of funds credited to a bank account exists:

(i) Automatically upon the creation of a security right if the depositary bank is the secured creditor;

(ii) If the depositary bank has concluded a control agreement with the grantor and the secured creditor evidenced by a signed writing[6] according to which the depositary bank has agreed to follow instructions from the secured creditor with respect to the payment of funds credited to the bank account without further consent from the grantor; or

(iii) If the secured creditor is the account holder;

(o) "Debtor" means a person that owes performance of the secured obligation and includes a secondary obligor such as a guarantor of a secured obligation. The debtor may or may not be the person that creates the security right (see the definition of the term "grantor");

(p) "Debtor of the receivable" means a person liable for payment of a receivable. "Debtor of the receivable" includes a guarantor or other person secondarily liable for payment of the receivable;[7]

A guarantor in an accessory guarantee is not only a debtor of the receivable of which it has guaranteed the payment, but also a debtor of the receivable constituted by the guarantee, as an accessory guarantee is itself a receivable (i.e. there are two receivables);

(q) "Encumbered asset" means a tangible or intangible asset that is subject to a security right. The term also includes a receivable that has been the subject of an outright transfer;[8]

(r) "Equipment" means a tangible asset used by a person in the operation of its business;

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[5] United Nations publication, Sales No. E.97.V.12.

[6] For the meaning of the term "signed writing" in the context of electronic communications, see recommendations 9 and 10.

[7] See article 2, subparagraph (a), of the United Nations Assignment Convention.

[8] See the definition of "security right", as well as recommendation 3 and related commentary.

(s) "Financial contract" means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above;[9]

The reference in this definition to "any other transaction similar to any transaction referred to above entered into in financial markets" is intended to include the full range of transactions entered into in financial markets. The term is flexible. It includes any transaction entered into in financial markets under which payment rights are determined by reference to: (a) underlying asset classes; or (b) quantitative measures of economic or financial risk or value associated with an occurrence or contingency. Examples are transactions under which payment rights are determined by reference to weather statistics, freight rates, emissions allowances or economic statistics.

(t) "Financial lease right" (a term used only in the context of the non-unitary approach to acquisition financing) means a lessor's right in a tangible asset (other than a negotiable instrument or negotiable document) that is the object of a lease agreement under which, at the end of the lease:

(i) The lessee automatically becomes the owner of the asset that is the object of the lease;

(ii) The lessee may acquire ownership of the asset by paying no more than a nominal price; or

(iii) The asset has no more than a nominal residual value;

The term includes a hire-purchase agreement, even if not nominally referred to as a lease, provided that it meets the requirements of subparagraph (i), (ii) or (iii);

(u) "Grantor" means a person that creates a security right to secure either its own obligation or that of another person.[10] Under the unitary approach to acquisition financing, the term "grantor" of an acquisition security right includes a retention-of-title buyer or financial lessee. While an assignor in an outright transfer of a receivable does not assign the receivable in order to secure the performance of an obligation, for convenience of reference, the term "grantor" also includes an assignor in an outright transfer of a receivable;[11]

(v) "Guarantor/issuer" means a bank or other person that issues an independent undertaking;

(w) "Independent undertaking" means a letter of credit (commercial or standby), a confirmation of a letter of credit, an independent guarantee (including a demand- or first-demand-bank guarantee, or a counter-guarantee) or any other undertaking recognized as independent by law or practice rules such as the United Nations Guarantee and Stand-by Convention, the Uniform Customs and Practice for

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[9] See article 5, subparagraph (k), of the United Nations Assignment Convention; see also the relevant definition in the UNCITRAL Insolvency Guide.

[10] See the definition of the term "debtor".

[11] See the definition of "security right", as well as recommendation 3 and related commentary.

Documentary Credits, the Rules on International Standby Practices and the Uniform Rules for Demand Guarantees;

(x) "Insolvency court" means a judicial or other authority competent to control or supervise insolvency proceedings;

[*Note to the Commission: As the term "insolvency court" is used only in the definition of "insolvency proceedings" and in the insolvency chapter, the Commission may wish to consider deleting the definition of "insolvency court" and including an explanation of its meaning in chapter XIV on the impact of insolvency on a security right.*]

(y) "Insolvency estate" means the assets of the debtor subject to the insolvency proceedings;

(z) "Insolvency proceedings" means collective proceedings, subject to insolvency court supervision, either for reorganization or liquidation;

(aa) "Insolvency representative" means a person or body, including one appointed on an interim basis, authorized in insolvency proceedings to administer the reorganization or the liquidation of the insolvency estate;

(bb) "Intangible asset" means all forms of movable assets other than tangible assets and includes incorporeal rights, receivables and rights to the performance of obligations other than receivables;

(cc) "Intellectual property" means copyrights, trademarks, patents, service marks, trade secrets and designs and any other asset considered to be intellectual property under the domestic law of the enacting State or under an international agreement to which the enacting State is a party;

The definition of "intellectual property" is intended to ensure consistency of the Guide with intellectual property laws and treaties, while at the same time respecting the right of the legislator in a State enacting the recommendations of the Guide to align the definition with its own law and international obligations.

An enacting State may add to this list or subtract from it types of intellectual property to conform it to national law. The reference to international agreements is intended to refer to agreements, such as the Convention Establishing the World Intellectual Property Organization and the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS").

In order to clarify that these definitions and the recommendations referring to them apply only to tangible assets (and not to intangible assets such as intellectual property), reference is made in the definitions of the terms "acquisition security right", "acquisition financing right", "retention-of-title right" and "financial lease" to "tangible assets".

In the definition of the term "receivable", reference to "the performance of non-monetary obligations" has been deleted to clarify the understanding that the definition and the recommendations relating to receivables apply only to receivables and not, for example, to the rights of a licensee or the obligations of a licensor under a contractual license of intellectual property.

(dd) “Inventory” means tangible assets held for sale or lease in the ordinary course of the grantor’s business, as well as raw and semi-processed materials (work-in-process);

(ee) “Issuer” of a negotiable document means the person that is obligated to deliver the tangible assets covered by the document under the law governing negotiable documents, whether that person performs all obligations or not;

(ff) “Knowledge” means actual rather than constructive knowledge;

(gg) “Mass or product” means tangible assets other than money that are so physically associated or united with other tangible assets that they have lost their separate identity;

(hh) “Money” means currency currently authorized as legal tender by any State. It does not include funds credited to a bank account or negotiable instruments such as cheques;

(ii) “Negotiable document” means a document, such as a warehouse receipt or a bill of lading, that embodies a right to delivery of tangible assets and satisfies the requirements for negotiability under the law governing negotiable documents;

(jj) “Negotiable instrument” means an instrument, such as a cheque, bill of exchange or promissory note, that embodies a right to payment and satisfies the requirements for negotiability under the law governing negotiable instruments;

[*Note to the Commission: The Commission may wish to consider that a note should be inserted after the definitions of “negotiable instrument” and “negotiable document” along the following lines:*

> *“The Guide was prepared against the background of negotiable instruments and negotiable documents in paper form, in view of the particular difficulty of creating an electronic equivalent of paper-based negotiability. However, the Guide should not be interpreted as discouraging the use of electronic equivalents of paper negotiable instruments or negotiable documents. Thus, an enacting State that wishes to address this matter will need to devise special rules (the United Nations Convention on the Use of Electronic Communications in International Contracts does not address the electronic equivalent of paper-based negotiability for the same reason).”*[12]]

(kk) “Netting agreement” means an agreement between two or more parties that provides for one or more of the following:

(i) The net settlement of payments due in the same currency on the same date whether by novation or otherwise;

(ii) Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; or

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[12] See United Nations publication, Sales No. E.07.V.2, explanatory note, para. 7.

(iii) The set-off of amounts calculated as set forth in subparagraph (ii) of this definition under two or more netting agreements;[13]

(ll) "Nominated person" means a bank or other person that is identified in an independent undertaking by name or type (e.g. "any bank in country X") as being nominated to give value under an independent undertaking and that acts pursuant to that nomination and, in the case of a freely available independent undertaking, any bank or other person;

(mm) "Notice" means a communication in writing;[14]

[*Note to the Commission: The Commission may wish to consider adding to this definition wording along the following lines:*

"A person "notifies", "sends a notice" or "gives a notice" to another person by taking reasonable steps to inform the other person, whether or not the other person is actually so informed." The suggested text would explain the meaning of references in the Guide to "notifying", "sending" or "giving" "notices".]

(nn) "Notification of the assignment" means a communication in writing that reasonably identifies the assigned receivable and the assignee;[15]

(oo) "Original contract" means, in the context of a receivable created by contract, the contract between the assignor and the debtor of the receivable from which the receivable arises;

(pp) "Possession" (except as the term is used in recommendations 28 and 51-53 with respect to the issuer of a negotiable document) means the actual possession only of a tangible asset by a person or an agent or employee of that person, or by an independent person that acknowledges that it holds for that person. It does not include non-actual possession described by terms such as constructive, fictive, deemed or symbolic possession;

(qq) "Priority" means the right of a person to derive the economic benefit of its security right in preference to a competing claimant;

(rr) "Proceeds" means whatever is received in respect of encumbered assets, including what is received as a result of sale or other disposition or collection, lease or licence of an encumbered asset, proceeds of proceeds, civil and natural fruits, dividends, distributions, insurance proceeds and claims arising from defects in, damage to or loss of an encumbered asset;[16]

(ss) "Receivable" means a right to payment of a monetary obligation excluding a right to payment evidenced by a negotiable instrument, a right to receive the proceeds under an independent undertaking and a right to payment of funds credited to a bank account;[17]

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[13] See article 5, subparagraph (l), of the United Nations Assignment Convention.

[14] For the electronic equivalents of the terms "writing" and "signed writing", see recommendations 9 and 10.

[15] As to when notification of the assignment is effective, see recommendation 115.

[16] See article 5, subparagraph (j), of the United Nations Assignment Convention.

[17] For the definition of the term "receivable", see article 2, subparagraph (a), of the United Nations Assignment Convention; for the exclusions of bank deposits, letters of credit and negotiable

(tt) "Retention-of-title right" (a term used only in the context of the non-unitary approach to acquisition financing) means a seller's right in a tangible asset (other than a negotiable instrument or a negotiable document) pursuant to an arrangement with the buyer by which ownership of the asset is not transferred (or is not transferred irrevocably) from the seller to the buyer until the unpaid portion of the purchase price is paid;

(uu) "Right to receive the proceeds under an independent undertaking" means the right to receive a payment due, a draft accepted or deferred payment incurred or another item of value, in each case to be paid or delivered by the guarantor/issuer, confirmer or nominated person giving value for a draw under an independent undertaking. The term also includes the right to receive payment in connection with the purchase by a negotiating bank of a negotiable instrument or a document under a complying presentation. The term does not include:

(i) The right to draw under an independent undertaking; and

(ii) What is received upon honour of an independent undertaking;

A security right in the right to receive the proceeds under an independent undertaking (as an original encumbered asset) is different from a security right in "proceeds" (a key concept of the Guide) of assets covered in the Guide (see definition of the term "proceeds" and recommendation 19). Thus, what is received as a result of a complying presentation under an independent undertaking constitutes the "proceeds" of the right to receive the proceeds under an independent undertaking.

(vv) "Secured creditor" means a creditor that has a security right. While an outright transfer of a receivable does not secure the performance of an obligation, for convenience of reference, the term also includes the assignee in an outright transfer of a receivable;[18]

(ww) "Secured obligation" means an obligation secured by a security right;

(xx) "Secured transaction" means a transaction that creates a security right. While an outright transfer of a receivable does not secure the performance of an obligation, for convenience of reference, the term also includes an outright transfer of a receivable;[19]

(yy) "Security agreement" means an agreement, in whatever form or terminology, between a grantor and a creditor that creates a security right. While an outright transfer of a receivable does not secure the performance of an obligation, for convenience of reference, the term also includes an agreement for the outright transfer of a receivable;[20]

(zz) "Security right" means a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right. In the context of the unitary approach to acquisition financing, the term includes both acquisition

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instruments, see article 4, subparagraphs 2 (f) and 2 (g), and paragraph 3, respectively, of the United Nations Assignment Convention.

[18] See the definition of "security right", as well as recommendation 3 and related commentary.

[19] Ibid.

[20] Ibid.

security rights and non-acquisition security rights. In the context of the non-unitary approach to acquisition financing, it does not include a retention-of-title or financial lease right. While an outright transfer of a receivable does not secure payment or other performance of an obligation, for convenience of reference, the term "security right" also includes the right of the assignee in an outright transfer of a receivable.[21] The term does not include a personal right against a guarantor or other person liable for the payment of the secured obligation;

(aaa) "Subsequent assignment" means an assignment by the initial or any other assignee.[22] In the case of a subsequent assignment, the person that makes that assignment is the assignor and the person to which that assignment is made is the assignee; and

(bbb)"Tangible asset" means every form of corporeal movable asset. Among the categories of tangible asset are inventory, equipment, consumer goods, attachments, negotiable instruments, negotiable documents and money.

I. Key objectives of an effective and efficient secured transactions law*

1. In order to provide a broad policy framework for an effective and efficient secured transactions law (the "secured transactions law" is hereinafter referred to as "the law" or "this law"), the law should be designed:

(a) To promote secured credit;

(b) To allow utilization of the full value inherent in a broad range of assets to support credit in the widest possible array of secured transactions;

(c) To enable parties to obtain security rights in a simple and efficient manner;

(d) To provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions;

(e) To validate security rights in assets that remain in the possession of the grantor;

(f) To enhance predictability and transparency with respect to rights serving security purposes by providing for registration of a notice in a general security rights registry;

(g) To establish clear and predictable priority rules;

(h) To facilitate enforcement of creditor's rights in a predictable and efficient manner;

(i) To balance the interests of affected persons;

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* The key objectives could be included in a preamble or other statement accompanying the secured transactions law as a guide to the underlying legislative policies to be taken into account in the interpretation and application of the secured transactions law.

[21] Ibid.

[22] See article 2, subparagraph (b), of the United Nations Assignment Convention.

(j) To recognize party autonomy; and

(k) To harmonize secured transactions laws, including conflict-of-laws rules.

II. Scope of application and other general rules

Purpose

The purpose of provisions on the scope of application of the law is to establish a single comprehensive regime for secured transactions. The provisions specify the security rights and other rights to which the law applies.

Scope of application

2. Subject to recommendations 3-7,[23] the law should apply to all rights in movable assets created by agreement that secure payment or other performance of an obligation, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or secured creditor or the nature of the secured obligation. Thus, the law should apply to:

(a) Security rights in all types of movable asset, tangible or intangible, present or future, including inventory, equipment and other tangible assets, contractual and non-contractual receivables, contractual non-monetary claims, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, rights to receive the proceeds under an independent undertaking, and intellectual property;

(b) Security rights created or acquired by all legal and natural persons, including consumers, without, however, affecting rights under consumer-protection legislation;

(c) Security rights securing all types of obligation, present or future, determined or determinable, including fluctuating obligations and obligations described in a generic way; and

(d) All property rights created contractually to secure the payment or other performance of an obligation, including transfers of title to tangible assets for security purposes or assignments of receivables for security purposes, the various forms of retention-of-title sales and financial leases.

The law should also apply to security rights in proceeds of encumbered assets.

Outright transfers of receivables

3. The law should apply to outright transfers of receivables despite the fact that such transfers do not secure the payment or other performance of an obligation. This recommendation is subject to the exception provided in recommendation 164 (chapter X on the enforcement of a security right).

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[23] Where reference is made in a recommendation to recommendations in another chapter, the number and subject of the chapter in which those recommendations are included, are also referred to. Where no such reference is made, the recommendations referred to are in the same chapter as the recommendation that contains the reference.

[*Note to the Commission: The Commission may wish to note that, in line with the approach taken in the United Nations Assignment Convention, the Guide recommends that its recommendations (with the exception of certain recommendations on enforcement) apply to all assignments of receivables (including outright transfers of receivables). The commentary will explain the reasons for this approach and discuss in particular the practical need to have the recommendations on creation, third-party effectiveness and priority apply to all assignments of receivables.*

The commentary will also explain that, although the Guide applies to security rights in as well as to outright transfers of receivables in the same way that it applies to security rights and uses common terminology to describe both types of right, it does not transform outright transfers into security rights. Such a result (sometimes referred to as "re-characterization") would be undesirable and indeed harmful for important practices such as securitization of receivables (which, even when it involves a true sale, is generally subject to the regime applicable to secured transactions).

As provided in the definitions, with respect to receivables only, and as a matter of expression and for convenience of drafting only, references in the law to security rights are also references to the rights of an outright transferee of receivables, references to a secured creditor are also references to an outright transferee, references to a grantor are also references to an outright transferor and references to an encumbered asset are also references to a receivable that has been transferred outright.

The commentary will also explain that the Guide's coverage of outright transfers of receivables in addition to secured transactions, in no way obviates the distinction between an outright transfer of receivables and a transfer of a right in receivables as security for an obligation. By way of contrast, the Guide does make irrelevant any distinctions in form or terminology between transactions that secure payment or other performance of an obligation. Thus, for example, the creation of a right in a movable asset to secure payment or performance of an obligation is within the scope of the Guide whether the right is created by a transaction denominated as a transfer of the asset for security purposes (also sometimes known as a fiduciary transfer) or one that is denominated as a pledge.]

Limitations on scope

4. Notwithstanding recommendation 2, the law should not apply to:

(a) Aircraft, railway rolling stock, space objects, ships as well as other categories of mobile equipment, in so far as such asset is covered by a national law or an international agreement to which the State enacting legislation based on these recommendations (herein referred to as "the State" or "this State") is a party and the matters covered by this law are addressed in that national law or international agreement;

(b) Intellectual property in so far as the provisions of the law are inconsistent with national law or international agreements, to which the State is a party, relating to intellectual property;

(c) Securities;

(d) Payment rights arising under or from financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions; and

(e) Payment rights arising under or from foreign exchange transactions.

5. The law should not apply to immovable property except as provided in recommendations 25 and 48 (chapter IV on the creation of a security right).

6. The law should provide that if, under other law, a security right in an excluded type of asset (e.g. immovable property) extends to a type of proceeds to which this law applies (e.g. receivables), this law applies to the security right in the proceeds except to the extent that that other law applies to that security right.

7. The law should not include any other limitations to its scope of application. To the extent any other limitations are introduced, they should be set out in the law in a clear and specific way.

[*Note to the Commission: The Commission may wish to note that a previous version of this recommendation referred to employment benefits (see A/CN.9/WG.VI/WP.29). It was reformulated to avoid encouraging a State to further limit the scope of application of the law, and to ensure that any further limitation is set out in the law in a clear and transparent way. The Commission may wish to consider whether the policy in this recommendation is more appropriately reflected in the commentary.*]

Party autonomy

8. The law should provide that, except as otherwise provided in recommendations 15 (chapter IV on the creation of a security right), 108-109 (chapter VIII on the rights and obligations of the parties), 129-133 (chapter X on the enforcement of a security right), 174-183 (chapter XI, unitary approach to acquisition financing), 184-199 (chapter XI, non-unitary approach to acquisition financing), 200-212 and 214-224 (chapter XII on conflict of laws) the secured creditor and the grantor or the debtor may derogate from or vary by agreement its provisions relating to their respective rights and obligations. Such an agreement does not affect the rights of any person that is not a party to the agreement.[24]

Electronic communications

9. The law should provide that, where it requires that a communication or a contract should be in writing, or provides consequences for the absence of a writing, that requirement is met by an electronic communication if the information contained therein is accessible so as to be usable for subsequent reference.

10. The law should provide that, where the law requires that a communication or a contract should be signed by a person, or provides consequences for the absence of a signature, that requirement is met in relation to an electronic communication if:

(a) A method is used to identify the party and to indicate that person's intention in respect of the information contained in the electronic communication; and

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[24] See article 6 of the United Nations Assignment Convention.

(b) The method used is either:

(i) As reliable as appropriate for the purpose for which the electronic communication was generated or communicated, in the light of all the circumstances, including any relevant agreement; or

(ii) Proven in fact to have fulfilled the functions described in subparagraph (a) above, by itself or together with further evidence.[25]

III. Basic approaches to security

Purpose

The purpose of provisions on basic approaches to security is to ensure that the law:

(a) Applies to all contractually created rights in movable assets that secure the payment or other performance of an obligation ("functional approach"); and

(b) Provides for the appropriate implementation of the functional approach so as to ensure that all providers of financing are treated according to rules that produce functionally equivalent outcomes.

Functional approach

11. The law should adopt a functional approach, under which it covers all rights in movable assets that are created by agreement and secure the payment or other performance of an obligation, regardless of the form of the transaction or the terminology used by the parties (including rights of transferees under a transfer of title to tangible assets for security purposes, rights of an assignee under an assignment of receivables for security purposes, as well as rights of sellers or financial lessors under various forms of retention-of-title and financial leases, respectively). Except with respect to acquisition financing, the functional approach should be implemented in a way that classifies all rights securing the performance of an obligation as security rights and subjects them to a common set of rules.

12. With respect to acquisition financing, the functional approach may be implemented either:

(a) In a way that classifies as acquisition security rights all rights in movable assets that secure the payment or other performance of an obligation, and that makes them subject to a common set of rules ("the unitary approach to acquisition financing" or "the unitary approach"); or

(b) In a way that classifies:

(i) As acquisition security rights all rights in movable assets that secure the payment or other performance of an obligation, other than the rights of a seller under a retention-of-title agreement and of a lessor under a financial lease;

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[25] For recommendations 9 and 10, see article 9, paragraphs 2 and 3, of the United Nations Convention on the Use of Electronic Communications in International Contracts.

(ii) As ownership rights the rights of a seller under a retention-of-title agreement and of a lessor under a financial lease, but makes those ownership rights subject to rules that produce outcomes that are the functional equivalent of the outcomes produced with respect to acquisition security rights, thereby ensuring that all providers of acquisition financing are treated equally (the approach in subparagraph (b) of this recommendation is referred to as "the non-unitary approach to acquisition financing" or "the non-unitary approach").

[*Note to the Commission: The Commission may wish to note that this recommendation has been redrafted to reflect the Commission's understanding with respect to the functional approach and the way it is to be implemented with respect to acquisition security rights (in a unitary or a non-unitary way; see chapter XI on acquisition financing).*]

IV. Creation of a security right (effectiveness as between the parties)

Purpose

The purpose of provisions on the creation of a security right is to specify the requirements that must be satisfied in order for a security right to be effective between the parties.

A. General recommendations*

Creation of a security right

13. The law should provide that a security right in an asset is created by an agreement concluded between the grantor and the secured creditor. In the case of an asset with respect to which the grantor has rights or the power to encumber at the time of the conclusion of the agreement, the security right in that asset is created at that time. In the case of an asset with respect to which the grantor acquires rights or the power to encumber thereafter, the security right in that asset is created when the grantor acquires rights in the asset or the power to encumber the asset.

Minimum content of a security agreement

14. The law should provide that a security agreement must:

(a) Reflect the intent of the parties to create a security right;

(b) Identify the secured creditor and the grantor;

(c) Describe the secured obligation; and

(d) Describe the encumbered assets in a manner that reasonably allows their identification.

[*Note to the Commission: The Commission may wish to note that the commentary will explain that the description need not be specific. A general*

* The general recommendations apply to security rights in all types of asset covered in the Guide, as modified by the asset-specific recommendations.

description by category, type or class of asset is sufficient (e.g. "desk", "furniture", "office furniture" or "equipment", "all present and future assets" or "all present and future inventory").

The Commission may wish to note that recommendation 57, subparagraph (a), for confidentiality reasons, permits the secured creditor to avoid disclosing its name on the notice to be registered. The Commission may wish to consider whether, for the same or other reasons, it would be sufficient for the security agreement to identify a representative of the secured creditor rather than the secured creditor itself.]

Form of the security agreement

15. The law should provide that a security agreement may be oral if accompanied by the secured creditor's possession of the encumbered asset. Otherwise, the agreement must be concluded in or evidenced by a writing that, in conjunction with the course of conduct between the parties, indicates the grantor's intent to create a security right.

Obligations secured by a security right

16. The law should provide that a security right may secure any type of obligation, whether present or future, determined or determinable, conditional or unconditional, fixed or fluctuating.

Assets subject to a security right

17. The law should provide that a security right may encumber any type of asset, including parts of assets and undivided rights in assets. A security right may encumber assets that, at the time the security agreement is concluded, may not yet exist or that the grantor may not yet own or have the power to encumber. It may also encumber all assets of a grantor. Any exceptions to these rules should be limited and described in the law in a clear and specific way.

18. The law should provide that, except as provided in recommendations 23-25, it does not override provisions of any other law to the extent that they limit the creation or enforcement of a security right in, or the transferability of, specific types of asset.

Continuation of a security right in proceeds

19. The law should provide that, unless otherwise agreed by the parties to a security agreement, a security right in an encumbered asset extends to its identifiable proceeds (including proceeds of proceeds).

Commingled proceeds

20. The law should provide that, where proceeds in the form of money or funds credited to a bank account have been commingled with other assets of the same kind so that the proceeds are no longer identifiable, the amount of the proceeds immediately before they were commingled is to be treated as identifiable proceeds after commingling. However, if, at any time after commingling, the total amount of the asset is less than the amount of the proceeds, the total amount of the asset at the

time that its amount is lowest plus the amount of any proceeds later commingled with the asset is to be treated as identifiable proceeds.

Creation and continuation of a security right in an attachment

21. The law should provide that a security right may be created in a tangible asset that is an attachment at the time of creation of the security right or continues in a tangible asset that becomes an attachment subsequently. A security right in an attachment to immovable property may be created under this law or under the law governing immovable property.

Continuation of a security right into a mass or product

22. The law should provide that a security right created in tangible assets before they are commingled in a mass or product continues in the mass or product. The security right that continues in the mass or product is limited to the value of the assets immediately before they became part of the mass or product.

B. Asset-specific recommendations

Effectiveness of a bulk assignment of receivables and an assignment of future, parts of and undivided interests in receivables

23. The law should provide that:

(a) An assignment of contractual receivables that are not specifically identified, future receivables and parts of or undivided interests in receivables is effective as between the assignor and the assignee and as against the debtor of the receivable, as long as, at the time of the assignment or, in the case of future receivables, at the time they arise, they can be identified to the assignment to which they relate; and

(b) Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable.[26]

Effectiveness of an assignment of receivables made despite an anti-assignment clause

24. The law should provide that:

(a) An assignment of a receivable is effective as between the assignor and the assignee and as against the debtor of the receivable notwithstanding an agreement between the initial or any subsequent assignor and the debtor of the receivable or any subsequent assignee limiting in any way the assignor's right to assign its receivables;

(b) Nothing in this recommendation affects any obligation or liability of the assignor for breach of the agreement mentioned in subparagraph (a) of this recommendation, but the other party to such an agreement may not avoid the original contract or the assignment contract on the sole ground of that breach.

[26] For recommendations 23-25, see articles 8-10 of the United Nations Assignment Convention.

A person that is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement;

(c) This recommendation applies only to assignments of receivables:

(i) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of immovable property;

(ii) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;

(iii) Representing the payment obligation for a credit card transaction; or

(iv) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

Creation of a security right in a personal or property right securing a receivable, a negotiable instrument or any other intangible asset

25. The law should provide that:

(a) A secured creditor with a security right in a receivable, negotiable instrument or any other intangible asset covered by this law has the benefit of any personal or property right that secures payment or other performance of the receivable, negotiable instrument or intangible asset automatically, without further action by either the grantor or the secured creditor;

(b) If the personal or property right is an independent undertaking, the security right automatically extends to the right to receive the proceeds under the independent undertaking but does not extend to the right to draw under the independent undertaking;

(c) This recommendation does not affect a right in immovable property that under other law is transferable separately from a receivable, negotiable instrument or other intangible asset that it may secure;

(d) A secured creditor with a security right in a receivable, negotiable instrument or any other intangible asset covered by this law has the benefit of any personal or property right securing payment or other performance of the receivable, negotiable instrument or other intangible asset notwithstanding any agreement between the grantor and the debtor of the receivable or the obligor of the negotiable instrument or other intangible asset limiting in any way the grantor's right to create a security right in the receivable, negotiable instrument or other intangible asset, or in any personal or property right securing payment or other performance of the receivable, negotiable instrument or other intangible asset;

(e) Nothing in this recommendation affects any obligation or liability of the grantor for breach of the agreement mentioned in subparagraph (d) of this recommendation, but the other party to such an agreement may not avoid the contract from which the receivable, negotiable instrument or other intangible asset arises, or the security agreement creating the personal or property security right on the sole ground of that breach. A person that is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement;

(f) Subparagraphs (d) and (e) of this recommendation apply only to security rights in receivables, negotiable instruments or other intangible assets:

(i) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of immovable property;

(ii) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;

(iii) Representing the payment obligation for a credit card transaction; or

(iv) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties;

(g) Subparagraph (a) of this recommendation does not affect any duties of the grantor to the debtor of the receivable or to the obligor of the negotiable instrument or other intangible asset; and

(h) To the extent that the automatic effects under subparagraph (a) of this recommendation and recommendation 50 are not impaired, this recommendation does not affect any requirement under other law relating to the form or registration of the creation of a security right in any asset, securing payment or other performance of a receivable, negotiable instrument or other intangible asset that is not covered by this law.

Creation of a security right in a right to payment of funds credited to a bank account

26. The law should provide that a security right in a right to payment of funds credited to a bank account is effective notwithstanding an agreement between the grantor and the depositary bank limiting in any way the grantor's right to create such a security right. However, the depositary bank has no duty to recognize the secured creditor and no obligation is otherwise imposed on the depositary bank with respect to the security right without the depositary bank's consent (for the depositary bank's rights and obligations, see recommendations 122 and 123; chapter IX on the rights and obligations of third-party obligors).

Creation of a security right in a right to receive the proceeds under an independent undertaking

27. The law should provide that a beneficiary of an independent undertaking may create a security right in a right to receive the proceeds under an independent undertaking, even if the right to draw under the independent undertaking is itself not transferable under the law and practice governing independent undertakings. The creation of a security right in a right to receive the proceeds under an independent undertaking is not a transfer of the right to draw under an independent undertaking.

Extension of a security right in a negotiable document to the tangible assets covered by the negotiable document

28. The law should provide that a security right in a negotiable document extends to the tangible assets covered by the document, provided that the issuer is in

possession of the assets, directly or indirectly, at the time the security right in the document is created.

V. Effectiveness of a security right against third parties

Purpose

The purpose of provisions on the effectiveness of a security right against third parties is to create a foundation for the predictable, fair and efficient ordering of priority by:

(a) Requiring registration as a precondition for the effectiveness of a security right against third parties, except where exceptions and alternatives to registration are appropriate in light of countervailing commercial policy considerations; and

(b) Establishing a legal framework to create and support a simple, cost-efficient and effective public registry system for the registration of notices with respect to security rights.

A. General recommendations

Achieving third-party effectiveness

29. The law should provide that a security right is effective against third parties only if it is created and one of the methods for achieving third-party effectiveness referred to in recommendation 32, 34 or 35 has been followed.

Effectiveness against the grantor of a security right that is not effective against third parties

30. The law should provide that a security right that has been created is effective between the grantor and the secured creditor even if it is not effective against third parties.

Continued third-party effectiveness after a transfer of the encumbered asset

31. The law should provide that, after transfer of a right other than a security right in an encumbered asset, a security right in the encumbered asset that is effective against third parties at the time of the transfer continues to encumber the asset except as provided in recommendations 76-78 (chapter VII on the priority of a security right), and remains effective against third parties except as provided in recommendation 62.

[*Note to the Commission: The Commission may wish to note that recommendations 32-36 are not intended to state the relevant rules but rather to list, for the ease of the reader, the various methods for achieving third-party effectiveness and to refer to the following recommendations that state the relevant rules.*]

General method for achieving third-party effectiveness: registration

32. The law should provide that a security right is effective against third parties if a notice with respect to the security right is registered in the general security rights registry referred to in recommendations 54-72 (chapter VI on the registry system).

33. The law should provide that registration of a notice does not create a security right and is not necessary for the creation of a security right.

Alternatives and exceptions to registration for achieving third-party effectiveness

34. The law should provide that:

(a) A security right may also be made effective against third parties by one of the following alternative methods:

(i) In tangible assets, by the secured creditor's possession, as provided in recommendation 37;

(ii) In tangible assets covered by a negotiable document, by the secured creditor's possession of the document, as provided in recommendations 51-53;

(iii) In movable assets subject to registration in a specialized registry or notation on a title certificate, by such registration or notation, as provided in recommendation 38;

(iv) In a right to payment of funds credited to a bank account, by control, as provided in recommendation 49; and

(v) In an attachment to immovable property, by registration in the immovable property registry, as provided in recommendation 43;

(b) A security right is effective against third parties automatically:

(i) In proceeds, if the security right in the original encumbered asset is effective against third parties, as provided in recommendations 39 and 40;

(ii) In an attachment to movable property, if the security right in the asset that becomes an attachment was effective against third parties before it became an attachment, as provided in recommendation 42;

(iii) In a mass or product, if the security right in processed or commingled assets was effective against third parties before they became part of the mass or product, as provided in recommendation 44; and

(iv) In movable assets, upon a change in the location of the asset or the grantor to this State, as provided in recommendation 45; and

(c) A security right in a personal or property right securing payment or other performance of a receivable, negotiable instrument or other intangible asset is effective against third parties, as provided in recommendation 48.

Method for achieving third-party effectiveness of a security right in a right to receive the proceeds under an independent undertaking

35. The law should provide that, except as provided in recommendation 48, a security right in a right to receive the proceeds under an independent undertaking

may be made effective against third parties only by control, as provided in recommendation 50.

Different third-party effectiveness methods for different types of asset

36. The law should provide that different methods for achieving third-party effectiveness may be used for different types of encumbered asset, whether they are encumbered pursuant to the same security agreement or not.

Third-party effectiveness of a security right in tangible assets by possession

37. The law should provide that a security right in tangible assets may be made effective against third parties by registration as provided in recommendation 32 or by the secured creditor's possession.

Third-party effectiveness of a security right in movable assets subject to a specialized registration or a title certificate system

38. The law should provide that a security right in movable assets that is subject to registration in a specialized registry or notation on a title certificate under other law may be made effective against third parties by registration as provided in recommendation 32 or by:

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

Automatic third-party effectiveness of a security right in proceeds

39. The law should provide that, if a security right in an encumbered asset is effective against third parties, a security right in any proceeds of the encumbered asset (including any proceeds of proceeds) is effective against third parties when the proceeds arise, provided that the proceeds are described in a generic way in a registered notice or that the proceeds consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

40. If the proceeds are not described in the registered notice or do not consist of the types of asset referred to in recommendation 39, the security right in the proceeds is effective against third parties for [a short period of time to be specified] days after the proceeds arise and continuously thereafter, if it was made effective against third parties by one of the methods referred to in recommendation 32 or 34 before the expiry of that time period.

Automatic third-party effectiveness of a security right in an attachment

41. The law should provide that, if a security right in a tangible asset is effective against third parties at the time when the asset becomes an attachment, the security right remains effective against third parties thereafter.

Third-party effectiveness of a security right in an attachment subject to a specialized registration or a title certificate system

42. The law should provide that a security right in an attachment to movable property that is subject to registration in a specialized registry or notation on a title

certificate under other law may be made effective against third parties automatically as provided in recommendation 41 or by:

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

43. The law should provide that a security right in an attachment to immovable property may be made effective against third parties automatically as provided in recommendation 41 or by registration in the immovable property registry.

Automatic third-party effectiveness of a security right in a mass or product

44. The law should provide that, if a security right in a tangible asset is effective against third parties when it becomes part of a mass or product, the security right that continues in the mass or product, as provided in recommendation 22 (chapter IV on the creation of a security right), is effective against third parties.

Continuity in third-party effectiveness upon change of location to this State

45. The law should provide that, if a security right in an encumbered asset is effective against third parties under the law of the State in which the encumbered asset or the grantor is located (whichever determines the applicable law under the conflict-of-laws provisions), and that location changes to this State, the security right continues to be effective against third parties under the law of this State for [a short period of time to be specified] days after the change. If the requirements of the law of this State to make the security right effective against third parties are satisfied prior to the end of that period, the security right continues to be effective against third parties thereafter under the law of this State. For the purposes of any rule of this State in which time of registration or other method of achieving third-party effectiveness is relevant for determining priority, that time is the time when registration or third-party effectiveness was achieved under the law of the State in which the encumbered assets or the grantor were located before their location changed to this State.

Continuity in third-party effectiveness of a security right upon change of method of third-party effectiveness

46. The law should provide that third-party effectiveness of a security right is continuous notwithstanding a change in the method by which it is made effective against third parties, provided that there is no time when the security right is not effective against third parties.

Lapse in third-party effectiveness or advance registration

47. The law should provide that, if a security right has been made effective against third parties and subsequently there is a period during which the security right is not effective against third parties, third-party effectiveness may be re-established. In such a case, third-party effectiveness takes effect from the time it is re-established. Similarly, if registration made before creation of a security right as provided in recommendation 64 expires as provided in recommendation 66 (chapter VI on the registry system), it may be re-established. In such a case, registration takes effect from the time when the new notice with respect to the security right is registered.

B. Asset-specific recommendations

Third-party effectiveness of a security right in a personal or property right securing payment of a receivable, negotiable instrument or any other intangible asset

48. The law should provide that, if a security right in a receivable, negotiable instrument or any other intangible asset covered by this law is effective against third parties, such third-party effectiveness extends to any personal or property right that secures payment or other performance of the receivable, negotiable instrument or other intangible asset, without further action by either the grantor or the secured creditor. If the personal or property right is an independent undertaking, its third-party effectiveness automatically extends to the right to receive the proceeds under the independent undertaking (but, as provided in recommendation 25, subparagraph (b), of chapter IV on the creation of a security right, the security right does not extend to the right to draw under the independent undertaking). This recommendation does not affect a right in immovable property that under other law is transferable separately from a receivable, negotiable instrument or other intangible asset that it may secure.

Third-party effectiveness of a security right in a right to payment of funds credited to a bank account

49. The law should provide that a security right in a right to payment of funds credited to a bank account may be made effective against third parties by registration as provided in recommendation 32 or by the secured creditor obtaining control with respect to the right to payment of funds credited to the bank account.

Third-party effectiveness of a security right in a right to receive the proceeds under an independent undertaking

50. The law should provide that, except as provided in recommendation 48, a security right in a right to receive the proceeds under an independent undertaking may be made effective against third parties only by the secured creditor obtaining control with respect to the right to receive the proceeds under the independent undertaking.

Third-party effectiveness of a security right in a negotiable document or assets covered by a negotiable document

51. The law should provide that a security right in a negotiable document may be made effective against third parties by registration as provided in recommendation 32 or by the secured creditor's possession of the document.

52. The law should provide that, if a security right in a negotiable document is effective against third parties, the corresponding security right in the assets covered by the document is also effective against third parties. During the period when a negotiable document covers assets, a security right in the assets may be made effective against third parties by the secured creditor's possession of the document.

53. The law should provide that a security right in a negotiable document that was made effective against third parties by the secured creditor's possession of the

document remains effective against third parties for [a short period of time to be specified] days after the negotiable document has been relinquished to the grantor or other person for the purpose of ultimate sale or exchange, loading or unloading, or otherwise dealing with the assets covered by the negotiable document.

VI. The registry system

Purpose

The purpose of provisions on the registry system is to establish a general security rights registry and to regulate its operation. The purpose of the registry system is to provide:

(a) A method by which an existing or future security right in a grantor's existing or future assets may be made effective against third parties;

(b) An efficient point of reference for priority rules based on the time of registration of a notice with respect to a security right; and

(c) An objective source of information for third parties dealing with a grantor's assets (such as prospective secured creditors and buyers, judgement creditors and the grantor's insolvency representative) as to whether the assets may be encumbered by a security right.

To achieve this purpose, the registry system should be designed to ensure that the registration and searching processes are simple, time- and cost-efficient, user-friendly and publicly accessible.

Operational framework of the registration and searching processes

54. The law should ensure that:

(a) Clear and concise guides to registration and searching procedures are widely available and information about the existence and role of the registry is widely disseminated;

(b) Registration is effected by registering a notice that provides the information specified in recommendation 57, as opposed to requiring the submission of the original or a copy of the security agreement or other document;

(c) The registry accepts a notice presented by an authorized medium of communication (e.g. paper, electronic) except if:

(i) It is not accompanied by the required fee;

(ii) It fails to provide a grantor identifier sufficient to allow indexing; or

(iii) It fails to provide some information with respect to any of the other items required under recommendation 57;

(d) The registrar does not require verification of the identity of the registrant or the existence of authorization for registration of the notice or conduct further scrutiny of the content of the notice;

(e) The record of the registry is centralized and contains all notices with respect to security rights registered under this law;

(f) The information provided on the record of the registry is available to the public;

(g) A search may be made without the need for the searcher to justify the reasons for the search;

(h) Notices are indexed and can be retrieved by searchers according to the name of the grantor or according to some other reliable identifier of the grantor;

(i) Fees for registration and for searching, if any, are set at a level no higher than necessary to permit cost recovery;

(j) If possible, the registration system is electronic. In particular:

(i) Notices are stored in electronic form in a computer database;

(ii) Registrants and searchers have immediate access to the registry record by electronic or similar means, including the Internet and electronic data interchange;

(iii) The system is programmed to minimize the risk of entry of incomplete or irrelevant information; and

(iv) The system is programmed to facilitate speedy and complete retrieval of information and to minimize the practical consequences of human error;

(k) Registrants may choose among multiple modes and points of access to the registry; and

(l) The registry, to the extent it is electronic, operates continuously except for scheduled maintenance, and, to the extent it is not electronic, operates during reliable and consistent service hours compatible with the needs of potential registry users.

Security and integrity of the registry

55. In order to ensure the security and integrity of the registry, the law should provide that the operational and legal framework of the registry should reflect the following characteristics:

(a) Although the day-to-day operation of the registry may be delegated to a private authority, the State retains the responsibility to ensure that it is operated in accordance with the governing legal framework;

(b) The identity of a registrant is requested and maintained by the registry;[27]

(c) The registrant is obligated to forward a copy of a notice to the grantor named in the notice. Failure of the secured creditor to meet this obligation may result only in nominal penalties and any damages resulting from the failure that may be proven;

(d) The registry is obligated to send promptly a copy of any changes to a registered notice to the person identified as the secured creditor in the notice;

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[27] As to verification of the registrant's identity, see recommendation 54, subparagraph (d).

(e) A registrant can obtain a record of the registration as soon as the registration information is entered into the registry record; and

(f) Multiple copies of all the information in the records of a registry are maintained and the entirety of the registry records can be reconstructed in the event of loss or damage.

Responsibility for loss or damage

56. The law should provide for the allocation of responsibility for loss or damage caused by an error in the administration or operation of the registration and searching system. If the system is designed to permit direct registration and searching by registry users without the intervention of registry personnel, the responsibility of the registry for loss or damage should be limited to system malfunction.

Required content of notice

57. The law should provide that the following information only is required to be provided in the notice:

(a) The identifier of the grantor, satisfying the standard provided in recommendations 58-60, and the secured creditor or its representative and their addresses;

(b) A description of the asset covered by the notice, satisfying the standard provided in recommendation 63;

(c) The duration of the registration as provided in recommendation 66; and

(d) If the State determines that the maximum monetary amount for which the security right may be enforced is helpful to facilitate subordinate lending, a statement of that maximum amount.

[*Note to the Commission: The Commission may wish to consider three additional recommendations (entitled, for example, erroneous notices) along the following lines:*

"X. The law should provide that an error in the identifier or address of the secured creditor or its representative does not render a registered notice ineffective as long as it has not seriously misled a reasonable searcher.

"Y. The law should provide that an error in the description of certain encumbered assets does not render a registered notice ineffective with respect to other assets sufficiently described.

"Z. The law should provide that an error in the information provided in the notice with respect to the duration of registration and the maximum amount secured, if applicable, does not render a registered notice ineffective."]

Sufficiency of grantor identifier

58. The law should provide that registration of a notice is effective only if it provides the grantor's correct identifier or, in the case of an incorrect statement, if

the notice would be retrieved by a search of the registry record under the correct identifier.

59. The law should provide that, where the grantor is a natural person, the identifier of the grantor for the purposes of effective registration is the grantor's name, as it appears in a specified official document. Where necessary, additional information, such as the birth date or identity card number, should be required to uniquely identify the grantor.

60. The law should provide that, where the grantor is a legal person, the grantor's identifier for the purposes of effective registration is the name that appears in the document constituting the legal person.

Impact of a change of the grantor's identifier on the effectiveness of the registration

61. The law should provide that, if, after a notice is registered, the identifier of the grantor used in the notice changes and as a result the grantor's identifier does not meet the standard provided in recommendations 58-60, the secured creditor may amend the registered notice to provide the new identifier in compliance with that standard. If the secured creditor does not register the amendment within [a short period of time to be specified] days after the change, the security right is ineffective against:

(a) A competing security right with respect to which a notice is registered or which is otherwise made effective against third parties before registration of the amendment; and

(b) A person that buys, leases or licenses the encumbered asset before registration of the amendment.

Impact of a transfer of an encumbered asset on the effectiveness of the registration

62. The law should provide that, if, after a notice is registered, the grantor transfers the encumbered asset, the secured creditor may amend the registered notice to provide the identifier of the transferee. If the secured creditor does not register the amendment within [a short period of time to be specified] days after the transfer, the security right is ineffective against:

(a) A competing security right with respect to which a notice is registered or which is otherwise made effective against third parties before registration of the amendment; and

(b) A person that buys, leases or licenses the encumbered asset before registration of the amendment.

Sufficiency of description of assets covered by a notice

63. The law should provide that a description of the encumbered assets in the notice that meets the requirements of recommendation 14, subparagraph (d) (chapter IV on the creation of a security right), is sufficient.

When notice may be registered

64. The law should provide that a notice with respect to a security right may be registered before or after creation of the security right, or conclusion of the security agreement.

One notice sufficient for multiple security rights arising from multiple agreements between the same parties

65. The law should provide that registration of a single notice is sufficient to achieve third-party effectiveness of one or more than one security right, whether they exist at the time of registration or are created thereafter, or whether they arise from one or more than one security agreement between the same parties.

Duration and extension of the registration of a notice

66. The law should either specify the duration of the effectiveness of the registration of a notice or permit the registrant to specify the duration in the notice at the time of registration and extend it at any time before its expiry. In either case, the secured creditor should be entitled to extend the period of effectiveness by submitting a notice of amendment to the registry at any time before the expiry of the effectiveness of the notice. If the law specifies the time of effectiveness of the registration, the extension period resulting from the registration of the notice of amendment should be an additional period equal to the initial period. If the law permits the registrant to specify the duration of the effectiveness of the registration, the extension period should be that specified in the notice of amendment.

Time of effectiveness of registration of a notice or amendment

67. The law should provide that registration of a notice or an amendment becomes effective when the information contained in the notice or the amendment is entered into the registry records so as to be available to searchers of the registry record.

Authority for registration

68. The law should provide that registration of a notice is ineffective unless authorized by the grantor in writing. The authorization may be given before or after registration. A written security agreement is sufficient to constitute authorization for the registration. The effectiveness of registration does not depend on the identity of the registrant.

Cancellation or amendment of notice

69. The law should provide that, if no security agreement has been concluded, the security right has been extinguished by full payment or otherwise, or a registered notice is not authorized by the grantor:

(a) The secured creditor is obliged to submit to the registry a notice of cancellation or amendment, to the extent appropriate, with respect to the relevant registered notice not later than [a short period of time to be specified] days after the secured creditor's receipt of a written request of the grantor;

(b) The grantor is entitled to seek cancellation or appropriate amendment of the notice through a summary judicial or administrative procedure;

(c) The grantor is entitled to seek cancellation or appropriate amendment of the notice, as provided in subparagraph (b), even before the expiry of the period provided in subparagraph (a), provided that there are appropriate mechanisms to protect the secured creditor.

70. The law should provide that the secured creditor is entitled to submit to the registry a notice of cancellation or amendment, to the extent appropriate, with respect to the relevant registered notice at any time.

71. The law should provide that promptly after a registered notice has expired as provided in recommendation 66 or has been cancelled as provided in recommendation 69 or 70, the information contained in the notice should be removed from the records of the registry, which are accessible to the public. However, the information provided in the expired or cancelled or amended notice and the fact of expiration or cancellation or amendment should be archived so as to be capable of retrieval if necessary.

72. The law should provide that, in the case of an assignment of the secured obligation, the notice may be amended to indicate the name of the new secured creditor but the unamended notice remains effective.

VII. Priority of a security right

Purpose

The purpose of provisions on the priority of a security right is:

(a) To provide rules for determining the priority of a security right in an efficient and predictable way; and

(b) To facilitate transactions by which a grantor may create more than one security right in the same asset and thereby use the full value of its assets to obtain credit.

A. General recommendations

Priority between security rights in the same encumbered assets

73. The law should provide that priority between competing security rights in the same encumbered assets is determined as follows:

(a) As between security rights that were made effective against third parties by registration of a notice, priority is determined by the order of registration, regardless of the order of creation of the security rights;

(b) As between security rights that were made effective against third parties otherwise than by registration, priority is determined by the order of third-party effectiveness;

(c) As between a security right that was made effective against third parties by registration and a security right that was made effective against third parties otherwise than by registration, priority is determined (regardless of when creation

occurs) by the order of registration or third-party effectiveness, whichever occurs first.

This recommendation is subject to the exceptions provided in recommendations 74, 75 and 84-106, as well as in recommendations 174-182 (chapter XI, unitary approach to acquisition financing).

Priority of a security or other right registered in a specialized registry or noted on a title certificate

74. The law should provide that a security right in an asset that is made effective against third parties by registration in a specialized registry or notation on a title certificate, as provided in recommendation 38 (chapter V on the third-party effectiveness of a security right), has priority as against:

(a) A security right in the same asset with respect to which a notice is registered in the general security rights registry or which is made effective against third parties by a method other than registration in a specialized registry or notation on a title certificate, regardless of the order; and

(b) A security right that is subsequently registered in the specialized registry or noted on a title certificate.

75. The law should provide that, if an encumbered asset is transferred, leased or licensed and, at the time of transfer, lease or licence, a security right in that asset is effective against third parties by registration in a specialized registry or notation on a title certificate, as provided in recommendation 38 (chapter V on the third-party effectiveness of a security right), the transferee, lessee or licensee takes its rights subject to the security right, except as provided in recommendations 76-78. However, if the security right has not been made effective against third parties by registration in a specialized registry or notation on a title certificate, a transferee, lessee or licensee takes its rights free of the security right.

Priority of rights of transferees, lessees and licensees of an encumbered asset

76. The law should provide that, if an encumbered asset is transferred, leased or licensed and a security right in that asset is effective against third parties at the time of the transfer, lease or licence, a transferee, lessee or licensee takes its rights subject to the security right except as provided in recommendations 75 and 77-79.

77. The law should provide that:

(a) A security right does not continue in an encumbered asset that the grantor sells or otherwise disposes of, if the secured creditor authorizes the sale or other disposition free of the security right; and

(b) The rights of a lessee or licensee of an encumbered asset are not affected by a security right if the secured creditor authorizes the grantor to lease or license the asset unaffected by the security right.

78. The law should provide that:

(a) A buyer of a tangible asset (other than a negotiable instrument or negotiable document) sold in the ordinary course of the seller's business takes free of a security right in the asset, provided that, at the time of the sale, the buyer does

not have knowledge that the sale violates the rights of the secured creditor under the security agreement;

(b) The rights of a lessee of a tangible asset (other than a negotiable instrument or document) leased in the ordinary course of the lessor's business are not affected by a security right in the asset, provided that, at the time of the conclusion of the lease, the lessee does not have knowledge that the lease violates the rights of the secured creditor under the security agreement; and

(c) The rights of a non-exclusive licensee of an intangible asset licensed in the ordinary course of the licensor's business are not affected by a security right in the asset, provided that, at the time of the conclusion of the licence agreement, the licensee does not have knowledge that the licence violates the rights of the secured creditor under the security agreement.

79. The law should provide that, if a buyer acquires a right in an encumbered asset free of a security right, any person that subsequently acquires a right in the asset from the buyer also takes free of the security right. If the rights of a lessee or licensee are not affected by a security right, the rights of a sub-lessee or sub-licensee are also unaffected by the security right.

Priority of preferential claims

80. The law should limit, both in type and amount, preferential claims arising by operation of law that have priority as against security rights and, to the extent preferential claims exist, they should be described in the law in a clear and specific way.

Priority of rights of judgement creditors

81. The law should provide that, a security right has priority as against the rights of an unsecured creditor, unless the unsecured creditor, under other law, obtained a judgement or provisional court order against the grantor and took the steps necessary to acquire rights in assets of the grantor by reason of the judgement or provisional court order before the security right was made effective against third parties. The priority of the security right extends to credit extended by the secured creditor:

(a) Before the expiry of [a short period of time to be specified] days after the unsecured creditor notified the secured creditor that it had taken the steps necessary to acquire rights in the encumbered asset; or

(b) Pursuant to an irrevocable commitment (in a fixed amount or an amount to be fixed pursuant to a specified formula) of the secured creditor to extend credit, if the commitment was made before the unsecured creditor notified the secured creditor that it had taken the steps necessary to acquire rights in the encumbered asset.

This recommendation is subject to the exception in recommendation 179 (chapter XI, unitary approach to acquisition financing).

Priority of rights of persons providing services with respect to an encumbered asset

82. The law should provide that, if other law gives rights equivalent to security rights to a creditor that has provided services with respect to an encumbered asset (e.g. by repairing, storing or transporting it), such rights are limited to the asset in the possession of that creditor up to the reasonable value of the services rendered and have priority as against security rights in the asset that were made effective against third parties by one of the methods referred to in recommendation 32 or 34 (chapter V on the third-party effectiveness of a security right).

Priority of a supplier's reclamation right

83. The law should provide that, if other law provides that a supplier of tangible assets has the right to reclaim them, the right to reclaim is subordinate to a security right that was made effective against third parties before the supplier exercised its right.

Priority of a security right in an attachment to immovable property

84. The law should provide that a security right or any other right (such as the right of a buyer or lessee) in an attachment to immovable property that is created and made effective against third parties under immovable property law, as provided in recommendations 21 and 43 (chapter IV on the creation of a security right), has priority as against a security right in that attachment that is made effective against third parties by one of the methods referred to in recommendation 32 or 34 (chapter V on the third-party effectiveness of a security right).

85. The law should provide that a security right in a tangible asset that is an attachment to immovable property at the time the security right is made effective against third parties or that becomes an attachment to immovable property subsequently, which is made effective against third parties by registration in the immovable property registry as provided in recommendation 43 (chapter V on the third-party effectiveness of a security right), has priority as against a security right or any other right (such as the right of a buyer or lessor) in the related immovable property that is registered subsequently in the immovable property registry.

Priority of a security right in an attachment to movable assets

86. A security right or any other right (such as the right of a buyer or lessee) in an attachment to movable property that is made effective against third parties by registration in a specialized registry or by notation on a title certificate as provided in recommendation 42 (chapter V on the third-party effectiveness of a security right), has priority as against a security right or other right in the related movable property that is subsequently registered in the specialized registry or noted on the title certificate.

Priority of a security right in a mass or product

87. The law should provide that, if two or more security rights in the same tangible asset continue in a mass or product as provided in recommendation 22 (chapter IX on the creation of a security right), they retain the same priority as the

security rights in the asset had as against each other immediately before the asset became part of the mass or product.

88. The law should provide that, if security rights in separate tangible assets continue in the same mass or product and each security right is effective against third parties, the secured creditors are entitled to share in the aggregate maximum value of their security rights in the mass or product according to the ratio of the value of the respective security rights. For purposes of this formula, the maximum value of a security right is the lesser of the value determined pursuant to recommendation 22 (chapter IV on the creation of a security right) and the amount of the secured obligation.

89. The law should provide that an acquisition security right in a separate tangible asset that continues in a mass or product and is effective against third parties has priority as against a security right granted by the same grantor in the mass or product.

Irrelevance of knowledge of the existence of a security right

90. The law should provide that knowledge of the existence of a security right on the part of a competing claimant does not affect priority.[28]

Subordination

91. The law should provide that a competing claimant entitled to priority may at any time subordinate its priority unilaterally or by agreement in favour of any other existing or future competing claimant.

Impact of continuity in third-party effectiveness on priority

92. The law should provide that, for the purpose of recommendation 73, the priority of a security right is not affected by a change in the method by which it is made effective against third parties, provided that there is no time when the security right is not effective against third parties.

93. The law should provide that, if a security right is covered by a registered notice or made effective against third parties and subsequently there is a period during which the security right is neither covered by a registered notice nor effective against third parties, the priority of the security right dates from the earliest time thereafter when the security right is either covered by a registered notice or made effective against third parties.

Priority of security rights securing existing and future obligations

94. The law should provide that, subject to recommendation 81, the priority of a security right extends to all secured obligations, regardless of the time when they are incurred.

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[28] As for the impact of knowledge that a transaction violates the rights of a secured creditor, see recommendations 78, 99, subparagraph (b), 102 and 103.

Extent of priority

95. The law should provide that, if a State implements recommendation 57, subparagraph (d) (chapter VI on the registry system), the priority of the security right is limited to the maximum amount set out in the registered notice.

Application of priority rules to a security right in after-acquired assets

96. The law should provide that, for purposes of recommendation 73, subparagraphs (a) and (c), the priority of a security right extends to all encumbered assets covered by the registered notice, irrespective of whether they are acquired by the grantor or come into existence before, at or after the time of registration.

Application of priority rules to a security right in proceeds

97. The law should provide that, for purposes of recommendation 73, the time of third-party effectiveness or the time of registration of a notice as to a security right in an encumbered asset is also the time of third-party effectiveness or registration as to a security right in its proceeds.

B. Asset-specific recommendations

Priority of a security right in a negotiable instrument

98. The law should provide that a security right in a negotiable instrument that is made effective against third parties by possession of the instrument, as provided in recommendation 37 (chapter V on the third-party effectiveness of a security right), has priority as against a security right in a negotiable instrument that is made effective against third parties by any other method.

99. The law should provide that a security right in a negotiable instrument that is made effective against third parties by a method other than possession of the instrument is subordinate to the rights of a secured creditor, buyer or other transferee (by agreement) that:

(a) Qualifies as a protected holder under the law governing negotiable instruments; or

(b) Takes possession of the negotiable instrument and gives value in good faith and without knowledge that the transfer is in violation of the rights of the secured creditor under the security agreement.

Priority of a security right in a right to payment of funds credited to a bank account

100. The law should provide that a security right in a right to payment of funds credited to a bank account that is made effective against third parties by control, as provided in recommendation 49 (chapter V on the third-party effectiveness of a security right), has priority as against a competing security right that is made effective against third parties by any other method. If a depositary bank concludes control agreements with more than one secured creditor, priority among those secured creditors is determined according to the order in which the control agreements are concluded. If the depositary bank is the secured creditor, its security

right has priority as against any other security right (including a security right made effective against third parties by a control agreement with the depositary bank even if the depositary bank's security right is later in time) except a security right of a secured creditor that obtains control by becoming the account holder.

101. The law should provide that a right under other law of a depositary bank to set off obligations owed to the depositary bank by the grantor against the grantor's right to payment of funds credited to a bank account has priority as against a security right except a security right of a secured creditor that obtains control by becoming the account holder.

102. The law should provide that, in the case of a transfer of funds from a bank account initiated by the grantor, the transferee of the funds takes free of a security right in the right to payment of funds credited to the bank account, unless the transferee has knowledge that the transfer violates the rights of the secured creditor under the security agreement. This recommendation does not adversely affect the rights of transferees of funds from bank accounts under other law.

Priority of a security right in money

103. The law should provide that a person that obtains possession of money that is subject to a security right takes the money free of the security right, unless that person has knowledge that the transfer violates the rights of the secured creditor under the security agreement. This recommendation does not adversely affect the rights of holders of money under other law.

Priority of a security right in a right to receive the proceeds under an independent undertaking

104. The law should provide that a security right in a right to receive the proceeds under an independent undertaking that is made effective against third parties by control has priority as against a security right made effective against third parties pursuant to recommendation 48 (chapter V on the third-party effectiveness of a security right). If control has been achieved by acknowledgement and inconsistent acknowledgements have been given to more than one secured creditor by a person, priority among those security rights is determined according to the order in which the acknowledgements were given.

Priority of a security right in a negotiable document or tangible assets covered by a negotiable document

105. The law should provide that a security right in a negotiable document and the tangible assets covered thereby is subordinate to any superior rights acquired by a transferee of the document under the law governing negotiable documents.

106. The law should provide that a security right in a tangible asset made effective against third parties by possession of a negotiable document has priority as against a competing security right made effective against third parties by another method. This rule does not apply to a security right in an asset other than inventory if the security right of the secured creditor not in possession of the negotiable document was made effective against third parties before the earlier of:

(a) The time that the asset became covered by the negotiable document; and

(b) The time when an agreement was made between the grantor and the secured creditor in possession of the negotiable document providing for the asset to be covered by a negotiable document so long as the asset became so covered within [a short period of time to be specified] days from the date of the agreement.

VIII. Rights and obligations of the parties to a security agreement

Purpose

The purpose of provisions on the rights and obligations of the parties is to enhance efficiency of secured transactions and reduce transaction costs and potential disputes by:

(a) Providing mandatory rules relating to the rights and obligations of the party in possession of the encumbered asset;

(b) Providing non-mandatory rules relating to the rights and obligations of the parties that apply in cases where the parties have not addressed these matters in their agreement; and

(c) Providing non-mandatory rules to serve as a drafting aid or checklist of issues the parties may wish to address in their agreement.

A. General recommendations

Rights and obligations of the parties to a security agreement[29]

107. The law should provide that the mutual rights and obligations of the parties are determined by:

(a) The terms and conditions set forth in that agreement, including any rules or general conditions referred to therein;

(b) Any usage to which they have agreed; and

(c) Unless otherwise agreed, any practices they have established between themselves.

Mandatory rules

108. The law should provide that the party in possession of an encumbered asset must take reasonable steps to preserve the asset and its value.

109. The secured creditor must return an encumbered asset in its possession if the security right has been extinguished by full payment or otherwise.[30]

Non-mandatory rules

110. The law should provide that, unless otherwise agreed, the secured creditor is entitled:

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[29] For recommendation 107, see article 11 of the United Nations Assignment Convention.

[30] For the secured creditor's duty to cancel a registered notice, see recommendation 69, chapter VI on the registry system.

(a) To be reimbursed for reasonable expenses incurred for the preservation of an encumbered asset in its possession;

(b) To make reasonable use of an encumbered asset in its possession and to apply the revenues it generates to the payment of the secured obligation; and

(c) To inspect an encumbered asset in the possession of the grantor.

B. Asset-specific recommendations

Representations of the assignor[31]

111. With respect to an assignment of a contractual receivable, the law should provide that:

(a) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of conclusion of the contract of assignment that:

(i) The assignor has the right to assign the receivable;

(ii) The assignor has not previously assigned the receivable to another assignee; and

(iii) The debtor of the receivable does not and will not have any defences or rights of set-off;

(b) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor of the receivable has, or will have, the ability to pay.

Right to notify the debtor of the receivable

112. The law should provide that:

(a) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor of the receivable notification of the assignment and a payment instruction, but after notification has been sent only the assignee may send such an instruction; and

(b) Notification of the assignment or a payment instruction sent in breach of any agreement referred to in subparagraph (a) of this recommendation is not ineffective for the purposes of recommendation 117 (chapter IX on the rights and obligations of third-party obligors) by reason of such breach. However, nothing in this recommendation affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

Right to payment

113. The law should provide that:

(a) As between the assignor and the assignee, unless otherwise agreed and whether or not notification of the assignment has been sent:

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[31] For recommendations 111-113, see articles 12-14 of the United Nations Assignment Convention.

(i) If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and tangible assets returned in respect of the assigned receivable;

(ii) If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and also to tangible assets returned to the assignor in respect of the assigned receivable; and

(iii) If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and also to tangible assets returned to such person in respect of the assigned receivable;

(b) The assignee may not retain more than the value of its right in the receivable.

IX. Rights and obligations of third-party obligors

Purpose

The purpose of provisions on the rights and obligations of third-party obligors is to enhance the efficiency of secured transactions where the encumbered asset is a payment obligation or other performance owed by a third party to the grantor by:

(a) Providing rules relating to rights and obligations of parties to the assignment of a receivable and the protection of the debtor of the receivable;

(b) Providing rules to ensure the coherence of secured transactions law with other law relating to the rights and obligations arising under negotiable instruments and negotiable documents; and

(c) Providing rules to ensure the coherence of the secured transactions regime with other law governing the rights and obligations of depositary banks, and of the guarantor/issuer, confirmer or nominated person under an independent undertaking.

A. Rights and obligations of the debtor of the receivable[32]

Protection of the debtor of the receivable

114. The law should provide that:

(a) Except as otherwise provided in this law, an assignment does not, without the consent of the debtor of the receivable, affect the rights and obligations of the debtor of the receivable, including the payment terms contained in the original contract; and

(b) A payment instruction may change the person, address or account to which the debtor of the receivable is required to make payment, but may not change:

[32] For recommendations 115-120, see articles 16-21 of the United Nations Assignment Convention.

(i) The currency of payment specified in the original contract; or

(ii) The State specified in the original contract in which payment is to be made to a State other than that in which the debtor of the receivable is located.

Notification of the assignment

115. The law should provide that:

(a) Notification of the assignment or a payment instruction is effective when received by the debtor of the receivable if it is in a language that is reasonably expected to inform the debtor of the receivable about its contents. It is sufficient if notification of the assignment or a payment instruction is in the language of the original contract;

(b) Notification of the assignment or a payment instruction may relate to receivables arising after notification; and

(c) Notification of a subsequent assignment constitutes notification of all prior assignments.

Discharge of the debtor of the receivable by payment

116. The law should provide that:

(a) Until the debtor of the receivable receives notification of the assignment, it is entitled to be discharged by paying in accordance with the original contract;

(b) After the debtor of the receivable receives notification of the assignment, subject to subparagraphs (c)-(h) of this recommendation, it is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor of the receivable, in accordance with such payment instruction;

(c) If the debtor of the receivable receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, it is discharged by paying in accordance with the last payment instruction received from the assignee before payment;

(d) If the debtor of the receivable receives notification of more than one assignment of the same receivable made by the same assignor, it is discharged by paying in accordance with the first notification received;

(e) If the debtor of the receivable receives notification of one or more subsequent assignments, it is discharged by paying in accordance with the notification of the last of such subsequent assignments;

(f) If the debtor of the receivable receives notification of the assignment of a part of or an undivided interest in one or more receivables, it is discharged by paying in accordance with the notification or in accordance with this recommendation as if the debtor of the receivable had not received the notification. If the debtor of the receivable pays in accordance with the notification, it is discharged only to the extent of the part or undivided interest paid;

(g) If the debtor of the receivable receives notification of the assignment from the assignee, it is entitled to request the assignee to provide within a

reasonable period of time adequate proof that the assignment from the initial assignor to the initial assignee and any intermediate assignment have been made and, unless the assignee does so, the debtor of the receivable is discharged by paying in accordance with this recommendation as if the notification from the assignee had not been received. Adequate proof of an assignment includes but is not limited to any writing emanating from the assignor and indicating that the assignment has taken place; and

(h) This recommendation does not affect any other ground on which payment by the debtor of the receivable to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor of the receivable.

Defences and rights of set-off of the debtor of the receivable

117. The law should provide that:

(a) In a claim by the assignee against the debtor of the receivable for payment of the assigned receivable, the debtor of the receivable may raise against the assignee all defences and rights of set-off arising from the original contract, or any other contract that was part of the same transaction, of which the debtor of the receivable could avail itself as if the assignment had not been made and such claim were made by the assignor;

(b) The debtor of the receivable may raise against the assignee any other right of set-off, provided that it was available to the debtor of the receivable at the time notification of the assignment was received by the debtor of the receivable; and

(c) Notwithstanding subparagraphs (a) and (b) of this recommendation, defences and rights of set-off that the debtor of the receivable may raise pursuant to recommendation 24, subparagraph (b), or recommendation 25, subparagraph (e) (chapter IV on the creation of a security right), against the assignor for breach of an agreement limiting in any way the assignor's right to make the assignment are not available to the debtor of the receivable against the assignee.

Agreement not to raise defences or rights of set-off

118. The law should provide that:

(a) The debtor of the receivable may agree with the assignor in a writing signed by the debtor of the receivable not to raise against the assignee the defences and rights of set-off that it could raise pursuant to recommendation 117. Such an agreement precludes the debtor of the receivable from raising against the assignee those defences and rights of set-off;

(b) The debtor of the receivable may not waive defences:

(i) Arising from fraudulent acts on the part of the assignee; or

(ii) Based on the incapacity of the debtor of the receivable; and

(c) Such an agreement may be modified only by an agreement in a writing signed by the debtor of the receivable. The effect of such a modification as against the assignee is determined by recommendation 119, subparagraph (b).

Modification of the original contract

119. The law should provide that:

(a) An agreement concluded before notification of the assignment between the assignor and the debtor of the receivable that affects the assignee's rights is effective as against the assignee, and the assignee acquires corresponding rights;

(b) An agreement concluded after notification of the assignment between the assignor and the debtor of the receivable that affects the assignee's rights is ineffective as against the assignee unless:

(i) The assignee consents to it; or

(ii) The receivable is not fully earned by performance and either the modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification; and

(c) Subparagraphs (a) and (b) of this recommendation do not affect any right of the assignor or the assignee arising from breach of an agreement between them.

Recovery of payments

120. The law should provide that failure of the assignor to perform the original contract does not entitle the debtor of the receivable to recover from the assignee a sum paid by the debtor of the receivable to the assignor or the assignee.

B. Rights and obligations of the obligor under a negotiable instrument

121. The law should provide that a secured creditor's rights in a negotiable instrument are, as against a person obligated on the negotiable instrument, subject to the law governing negotiable instruments.

C. Rights and obligations of the depositary bank

122. The law should provide that:

(a) The creation of a security right in a right to payment of funds credited to a bank account does not affect the rights and obligations of the depositary bank without its consent; and

(b) Any rights of set-off that the depositary bank may have under other law are not impaired by reason of any security right that the depositary bank may have in a right to payment of funds credited to a bank account.

123. The law should provide that it does not obligate a depositary bank:

(a) To pay any person other than a person that has control with respect to funds credited to a bank account;

(b) To respond to requests for information about whether a control agreement or a security right in its own favour exists and whether the grantor retains the right to dispose of the funds credited in the account; or

(c) To enter into a control agreement.

D. Rights and obligations of the guarantor/issuer, confirmer or nominated person of an independent undertaking

124. The law should provide that:

(a) A secured creditor's right in the right to receive the proceeds under an independent undertaking is subject to the rights, under the law and practice governing independent undertakings, of a guarantor/issuer, confirmer or nominated person and of any other beneficiary named in the undertaking or to whom a transfer of the right to draw has been effected;

(b) The rights of a transferee of an independent undertaking are not affected by a security right in the right to receive the proceeds under the independent undertaking acquired from the transferor or any prior transferor; and

(c) The independent rights of a guarantor/issuer, confirmer, nominated person or transferee of an independent undertaking are not adversely affected by reason of any security right it may have in the right to receive proceeds under the independent undertaking.

125. The law should provide that a guarantor/issuer, confirmer or nominated person is not obligated to pay any person other than a confirmer, a nominated person, a named beneficiary, an acknowledged transferee of the independent undertaking or an acknowledged assignee of the right to receive the proceeds under an independent undertaking.

126. The law should provide that, if a secured creditor obtains control by becoming an acknowledged assignee of the proceeds under an independent undertaking, the secured creditor has the right to enforce the acknowledgement against the guarantor/issuer, confirmer or nominated person that made the acknowledgement.

E. Rights and obligations of the issuer of a negotiable document

127. The law should provide that a secured creditor's rights in a negotiable document are, as against the issuer or any other person obligated on the negotiable document, subject to the law governing negotiable documents.

X. Enforcement of a security right

Purpose

The purpose of provisions on enforcement of security rights is to provide:

(a) Clear, simple and efficient methods for the enforcement of security rights after debtor default;

(b) Methods designed to maximize the net amount realized from the encumbered assets, for the benefit of the grantor, the debtor or any other person that

owes payment of the secured obligation, the secured creditor and other creditors with a right in the encumbered assets; and

(c) Expeditious judicial and, subject to appropriate safeguards, non-judicial methods for the secured creditor to exercise its rights.

A. General recommendations

General standard of conduct in the context of enforcement

128. The law should provide that a person must enforce its rights and perform its obligations under the provisions on enforcement in good faith and in a commercially reasonable manner.

Limitations on party autonomy

129. The law should provide that the general standard of conduct provided in recommendation 128 cannot be waived unilaterally or varied by agreement at any time.

130. The law should provide that, subject to recommendation 129, the grantor and any other person that owes payment or other performance of the secured obligation may waive unilaterally or vary by agreement any of its rights under the provisions on enforcement, but only after default.

131. The law should provide that, subject to recommendation 129, the secured creditor may waive unilaterally or vary by agreement any of its rights under the provisions on enforcement.

132. The law should provide that a variation of rights by agreement may not adversely affect the rights of any person not a party to the agreement. A person challenging the effectiveness of the agreement on the ground that is inconsistent with recommendation 129, 130 or 131 has the burden of proof.

Liability

133. The law should provide that, if a person fails to comply with its obligations under the provisions on enforcement, it is liable for damages caused by such failure.

Judicial or other relief for non-compliance

134. The law should provide that the debtor, the grantor or any other interested person (e.g. a secured creditor with a lower priority ranking than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered assets) is entitled at any time to apply to a court or other authority for relief from the secured creditor's failure to comply with its obligations under the provisions on the enforcement of a security right.

Expeditious judicial proceedings

135. The law should provide for expeditious proceedings to accommodate situations where the secured creditor, the grantor or any other person that owes performance of the secured obligation, or claims to have a right in an encumbered

asset, applies to a court or other authority with respect to the exercise of post-default rights.

Post-default rights of the grantor

136. The law should provide that, after default, the grantor is entitled to exercise one or more of the following rights:

(a) Pay in full the secured obligation and obtain a release from the security right of all encumbered assets, as provided in recommendation 137;

(b) Apply to a court or other authority for relief if the secured creditor is not complying with its obligations under the provisions of this law, as provided in recommendation 134;

(c) [Propose to the secured creditor, or] reject the proposal of the secured creditor[,] that the secured creditor acquire an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendation 156; and

(d) Exercise any other right provided in the security agreement or any law.

Extinction of the security right after full satisfaction of the secured obligation

137. The law should provide that the debtor, the grantor or any other interested person (e.g. a secured creditor whose security right has lower priority than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered asset) is entitled to satisfy the secured obligation in full, including payment of the costs of enforcement up to the time of full satisfaction. This right may be exercised until the disposition, acceptance or collection of an encumbered asset by the secured creditor [or the conclusion of an agreement by the secured creditor to dispose of the encumbered asset]. If all commitments to extend credit have terminated, full satisfaction of the secured obligation extinguishes the security right in all encumbered assets, subject to any rights of subrogation in favour of the person satisfying the secured obligation.

[*Note to the Commission: The Commission may wish to note that the bracketed text in this recommendation is intended to reflect the common practice of a secured creditor to enter into a contract to dispose of an encumbered asset before the actual disposition takes place.*]

Post-default rights of the secured creditor

138. The law should provide that, after default, the secured creditor is entitled to exercise one or more of the following rights with respect to an encumbered asset:

(a) Obtain possession of a tangible encumbered asset, as provided in recommendations 143 and 144;

(b) Sell or otherwise dispose of, lease or license an encumbered asset, as provided in recommendations 145-146;

(c) Propose that the secured creditor acquire an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendations 153-155;

(d) Enforce its security right in an attachment, as provided in recommendations 162 and 163;

(e) Collect on or otherwise enforce a security right in an encumbered asset that is a receivable, negotiable instrument, right to payment of funds credited to a bank account or right to receive the proceeds under an independent undertaking, as provided in recommendations 164-172;

(f) Enforce rights under a negotiable document, as provided in recommendation 173; and

(g) Exercise any other right provided in the security agreement (except to the extent inconsistent with the provisions of this law) or any law.

Judicial and extrajudicial methods of exercising post-default rights

139. The law should provide that, after default, the secured creditor may exercise its rights provided in recommendation 138 either by applying to a court or other authority, or without application to a court or other authority. Extrajudicial exercise of the secured creditor's rights is subject to the general standard of conduct provided in recommendation 128 and the requirements provided in recommendations 144-148 with respect to extrajudicial obtaining of possession and disposition of an encumbered asset.

Cumulative post-default rights

140. The law should provide that the exercise of one post-default right does not prevent the exercise of another right, except to the extent that the exercise of one right has made the exercise of another right impossible.

Post-default rights with respect to the secured obligation

141. The law should provide that the exercise of a post-default right with respect to an encumbered asset does not prevent the exercise of a post-default right with respect to the obligation secured by that asset, and vice versa.

Right of higher-ranking secured creditor to take over enforcement

142. The law should provide that, if a secured creditor has commenced enforcement by taking any of the actions described in the recommendations on enforcement or a judgement creditor has taken the steps referred to in recommendation 81 (chapter VII on the priority of a security right) a secured creditor whose security right has priority as against that of the enforcing secured creditor or the enforcing judgement creditor is entitled to take control of the enforcement process at any time before final disposition or acquisition [or collection] of an encumbered asset [or the conclusion of an agreement by the secured creditor to dispose of the encumbered asset]. The right to take control includes the right to enforce by any method available under the recommendations in this chapter.

[*Note to the Commission: The Commission may wish to delete the first bracketed text if it decides to adopt the new recommendation set out in the note after recommendation 164. The second bracketed text is intended to conform this recommendation to the bracketed text in recommendation 137.*]

Secured creditor's right to possession of an encumbered asset

143. The law should provide that after default the secured creditor is entitled to possession of a tangible encumbered asset.

Extrajudicial obtaining of possession of an encumbered asset

144. The law should provide that the secured creditor may elect to obtain possession of a tangible encumbered asset without applying to a court or other authority only if:

(a) The grantor has consented in the security agreement to the secured creditor obtaining possession without applying to a court or other authority;

(b) The secured creditor has given the grantor and any person in possession of the encumbered asset notice of default and of the secured creditor's intent to obtain possession without applying to a court or other authority; and

(c) At the time the secured creditor seeks to obtain possession of the encumbered asset the grantor does not object.

[*Note to the Commission: The Commission may wish to consider whether subparagraph (c) should also refer to the person in possession of the encumbered asset, and not just to the grantor.*

The Commission may also wish to consider whether, if at the time the secured creditor seeks to obtain possession of the encumbered asset the grantor and any other person in possession affirmatively consents, the requirements of subparagraphs (a), (b) and (c) do not need to be met. This result could be implemented by the addition in a separate sentence of text along the following lines:

> *"The requirements of subparagraphs (a), (b) and (c) of this recommendation need not be met if, at the time the secured creditor seeks to obtain possession of the encumbered asset, the grantor and any other person in possession of the encumbered asset affirmatively consent".*]

Extrajudicial disposition of an encumbered asset

145. The law should provide that, after default, a secured creditor is entitled, without applying to a court or other authority, to sell or otherwise dispose of, lease or license an encumbered asset to the extent of the grantor's rights in the encumbered asset. Subject to the standard of conduct provided in recommendation 128, a secured creditor that elects to exercise this right may select the method, manner, time, place and other aspects of the disposition, lease or licence.

Advance notice of extrajudicial disposition of an encumbered asset

146. The law should provide that, after default, the secured creditor must give notice of its intention to sell or otherwise dispose of, lease or licence an encumbered asset without applying to a court or other authority. The notice need not be given if the encumbered asset is perishable, may decline in value speedily or is of a kind sold on a recognized market.

147. The law should provide rules ensuring that the notice referred to in recommendation 146 can be given in an efficient, timely and reliable way so as to protect the grantor or other interested parties, while, at the same time, avoiding having a negative effect on the secured creditor's remedies and the potential net realization value of the encumbered assets.

148. With respect to the notice referred to in recommendation 146, the law should:

(a) Provide that the notice must be given to:

(i) The grantor, the debtor and any other person that owes performance of the secured obligation;

(ii) Any person with rights in the encumbered asset that, more than [to be specified] days before the sending of the notice by the secured creditor to the grantor, notifies in writing the secured creditor of those rights;

(iii) Any other secured creditor that, more than [to be specified] days before the notice is sent to the grantor, registered a notice with respect to a security right in the encumbered asset that is indexed under the identifier of the grantor; and

(iv) Any other secured creditor that was in possession of the encumbered asset at the time when the enforcing secured creditor took possession of the asset;

(b) State the manner in which the notice must be given, its timing and its minimum contents, including whether the notice must contain an accounting of the amount then owed and a reference to the right of the debtor or the grantor to obtain the release of the encumbered assets from the security right as provided in recommendation 137; and

(c) Provide that the notice must be in a language that is reasonably expected to inform its recipients about its contents.

[*Note to the Commission: The Commission may wish to consider whether subparagraph (c) should include language along the following lines:*

"It is sufficient if the notice is in the language of the security agreement being enforced".

Addition of this text would conform subparagraph (c) to article 16, paragraph 1, of the United Nations Assignment Convention, on which subparagraph (c) is based. The result would be that, if the recipients of the notice are located in several countries, it would be enough if the notice is in the language of the relevant security agreement.]

Distribution of proceeds of disposition of an encumbered asset

149. The law should provide that, in the case of extrajudicial disposition of an encumbered asset [or collection of a receivable, negotiable instrument or other obligation], the enforcing secured creditor must apply the net proceeds of its enforcement (after deducting costs of enforcement) to the secured obligation. Except as provided in recommendation 150, the enforcing secured creditor must pay any surplus remaining to any subordinate competing claimant that, prior to any distribution of the surplus, notified the enforcing secured creditor of the subordinate

competing claimant's claim, to the extent of the amount of that claim. The balance remaining, if any, must be remitted to the grantor.

[*Note to the Commission: The Commission may wish to replace the bracketed text in this recommendation with a new recommendation set out in the note after recommendation 164.*]

150. The law should also provide that, in the case of extrajudicial disposition of an encumbered asset, whether or not there is any dispute as to the entitlement of any competing claimant or as to the priority of payment, the enforcing secured creditor may, in accordance with generally applicable procedural rules, pay the surplus to a competent judicial or other authority or to a public deposit fund for distribution. The surplus should be distributed in accordance with the provisions of this law on priority.

151. The law should provide that distribution of the proceeds realized by a judicial disposition or other officially administered enforcement process is to be made pursuant to the general rules of the State governing execution proceedings, but in accordance with the provisions of this law on priority.

152. The law should provide that [, unless otherwise agreed,] the debtor and any other person that owes payment of the secured obligation remain liable for any shortfall owing after application of the net proceeds of enforcement to the secured obligation.

[*Note to the Commission: The Commission may wish to delete the bracketed text as recommendations 8 and 130 provide for party autonomy. If the bracketed text were retained, it might need to be added in all recommendations that are subject to party autonomy so as to avoid a negative implication as to the application of the principle of party autonomy.*]

Acquisition of encumbered assets in satisfaction of the secured obligation

153. The law should provide that, after default, the secured creditor may propose in writing to acquire one or more of the encumbered assets in total or partial satisfaction of the secured obligation.

154. With respect to the proposal referred to in recommendation 153, the law should:

(a) Provide that the proposal must be sent to:

(i) The grantor, the debtor and any other person that owes payment or other performance of the secured obligation (e.g. a guarantor);

(ii) Any person with rights in the encumbered asset that, more than [to be specified] days before the proposal is sent by the secured creditor to the grantor, has notified in writing the secured creditor of those rights;

(iii) Any other secured creditor that, more than [to be specified] days before the proposal is sent by the secured creditor to the grantor, registered a notice with respect to a security right in the encumbered asset indexed under the identifier of the grantor; and

(iv) Any other secured creditor that was in possession of the encumbered asset at the time the secured creditor took possession; and

(b) Provide that the proposal must specify the amount owed as of the date the proposal is sent and the amount of the obligation that is proposed to be satisfied by acquiring the encumbered asset.

155. The law should provide that the secured creditor may acquire the encumbered asset as provided in recommendation 153, unless the secured creditor receives an objection in writing from any person entitled to receive a proposal under recommendation 154 within [a short period of time to be specified] days, after the proposal is sent. In the case of a proposal for the acquisition of the encumbered asset in partial satisfaction, affirmative consent by each addressee of the proposal is necessary.

[*Note to the Commission: The Commission may wish to note that this recommendation was aligned with the preceding recommendations by referring to the secured creditor "receiving" an objection in writing.*]

156. The law should provide that the grantor may make a proposal such as that referred to in recommendation 153 and if the secured creditor accepts it, the secured creditor must proceed as provided in recommendations 154 and 155.

Rights acquired through judicial disposition

157. The law should provide that, if a secured creditor disposes of an encumbered asset through a judicial or other officially administered process, the rights acquired by the transferee are determined by the general rules of the State governing execution proceedings.

Rights acquired through extrajudicial disposition

158. The law should provide that, if a secured creditor sells or otherwise disposes of an encumbered asset without applying to a court or other authority, in accordance with this law, a person that acquires the grantor's right in the asset takes the asset subject to rights that have priority as against the security right of the enforcing secured creditor, but free of rights of the enforcing secured creditor and any competing claimant whose right has a lower priority than that of the enforcing secured creditor. The same rule applies to rights in an encumbered asset acquired by a secured creditor that has acquired the asset in total or partial satisfaction of the secured obligation.

159. The law should provide that, if a secured creditor leases or licenses an encumbered asset without applying to a court or other authority, in accordance with the law, a lessee or licensee is entitled to the benefit of the lease or licence during its term, except as against rights that have priority over the right of the enforcing secured creditor.

160. The law should provide that, if the secured creditor sells or otherwise disposes of, leases or licenses the encumbered asset not in accordance with the recommendations in this chapter, a good faith acquirer, lessee or licensee of the encumbered asset acquires the rights or benefits described in recommendations 158 and 159.

Intersection of movable and immovable property enforcement regimes

161. The law should provide that:

(a) The secured creditor may elect to enforce a security right in an attachment to immovable property in accordance with the recommendations in this chapter or the law governing enforcement of encumbrances in immovable property; and

(b) If an obligation is secured by both movable and immovable property of a grantor, the secured creditor may elect to enforce:

(i) The security right in the movable property under the provisions on enforcement of a security right in movable assets recommendations in this chapter and the encumbrance in the immovable property under the law governing enforcement of encumbrances in immovable property; or

(ii) Both rights under the law governing enforcement of encumbrances in immovable property.

Enforcement of a security right in attachments

162. The law should provide that a secured creditor with a security right in an attachment to immovable property is entitled to enforce its security right only if it has priority as against competing rights in the immovable property. A creditor with a competing right in immovable property that has lower priority is entitled to pay off the obligation secured by the security right of the enforcing secured creditor in the attachment. The enforcing secured creditor is liable for any damage to the immovable property caused by the act of removal other than any diminution in its value attributable solely to the absence of the attachment.

163. [The law should provide that a secured creditor with a security right in an attachment to a movable asset is entitled to enforce its security right in the attachment. A creditor with higher priority is entitled to take control of the enforcement process, as provided in recommendation 142. A creditor with lower priority may pay off the obligation secured by the security right of the enforcing secured creditor in the attachment. The enforcing secured creditor is liable for any damage to the movable asset caused by the act of removal other than any diminution in its value attributable solely to the absence of the attachment.]

[*Note to the Commission: The Commission may wish to consider and approve this recommendation, which was added to address the issue of the enforcement of a security right in an attachment to movable property.*]

B. Asset-specific recommendations

Application of the chapter on enforcement to outright transfers of receivables

164. The law should provide that the recommendations in this chapter do not apply to the collection or other enforcement of a receivable assigned by an outright transfer with the exception of:

(a) Recommendation 128 in the case of an outright transfer with recourse; and

(b) Recommendations 165 and 166.

[*Note to the Commission: The Commission may wish to replace the bracketed text in recommendation 142 with text along the following lines:*

> *"The law should provide that, in the case of collection or other enforcement of a receivable, negotiable instrument or enforcement of a claim, the enforcing secured creditor must apply the net proceeds of its enforcement (after deducting costs of enforcement) to the secured obligation. The enforcing secured creditor must pay any surplus remaining to the competing claimants that, prior to any distribution of the surplus, notified the enforcing secured creditor of the competing claimant's claim, to the extent of that claim. The balance remaining, if any, must be remitted to the grantor."*

The second sentence of this text is intended to give some protection to a secured creditor with a higher priority status than that of the enforcing secured creditor ("senior secured creditor"). Collection of receivables by a junior secured creditor should be distinguished from disposition of encumbered assets by a junior secured creditor. A senior secured creditor is protected because its security right in the asset disposed of continues (see recommendation 158).]

Enforcement of a security right in a receivable

165. The law should provide that, in the case of a receivable assigned by an outright transfer, subject to recommendations 114-120 (chapter IX on the rights and obligations of third-party obligors), the assignee has the right to collect or otherwise enforce the receivable. In the case of a receivable assigned by way of security, the assignee is entitled, subject to recommendations 114-120, to collect or otherwise enforce the receivable after default, or before default with the agreement of the assignor.

166. The law should provide that the assignee's right to collect or otherwise enforce a receivable includes the right to collect or otherwise enforce any personal or property right that secures payment of the receivable.

Enforcement of a security right in a negotiable instrument

167. The law should provide that, after default or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 121 (chapter IX on the rights and obligations of third-party obligors), to collect or otherwise enforce a negotiable instrument that is an encumbered asset against a person obligated on that instrument.

168. The law should provide that the secured creditor's right to collect or otherwise enforce a negotiable instrument includes the right to collect or otherwise enforce any personal or property right that secures payment of the negotiable instrument.

Enforcement of a security right in a right to payment of funds credited to a bank account

169. The law should provide that, after default or before default with the agreement of the grantor, a secured creditor with a security right in a right to payment of funds credited to a bank account is entitled, subject to recommendations 122 and 123 (chapter IX on the rights and obligations of third-party obligors), to collect or otherwise enforce its right to payment of the funds.

170. The law should provide that a secured creditor that has control is entitled, subject to recommendations 122 and 123 (chapter IX on the rights and obligations of third-party obligors), to enforce its security right without having to apply to a court or other authority.

171. The law should provide that a secured creditor that does not have control is entitled, subject to recommendations 122 and 123 (chapter IX on the rights and obligations of third-party obligors), to collect or otherwise enforce the security right in the right to payment of funds credited to a bank account against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

Enforcement of a security right in a right to receive the proceeds under an independent undertaking

172. The law should provide that, after default or before default with the agreement of the grantor, a secured creditor with a security right in a right to receive the proceeds under an independent undertaking is entitled, subject to recommendations 124-126 (chapter IX on the rights and obligations of third-party obligors), to collect or otherwise enforce its right in the right to receive the proceeds under the independent undertaking.

Enforcement of a security right in a negotiable document or tangible assets covered by a negotiable document

173. The law should provide that, after default or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 127 (chapter IX on the rights and obligations of third-party obligors), to enforce a security right in a negotiable document or the tangible assets covered by the document.

XI. Acquisition financing

Option A: Unitary approach to acquisition financing*

Purpose

The purpose of provisions on acquisition security rights is:

(a) To recognize the importance and facilitate the use of acquisition financing as a source of affordable credit, especially for small- and medium-sized businesses;

(b) To provide for equal treatment of all providers of acquisition financing; and

(c) To facilitate secured transactions in general by creating transparency with respect to acquisition financing.

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* A State may adopt option A (unitary approach to acquisition financing), i.e. recommendations 174-183, or option B (non-unitary approach to acquisition financing), i.e. recommendations 184-199. The recommendations outside this chapter are generally applicable except to the extent modified by the recommendations in this chapter.

An acquisition security right as a security right

174. The law should provide that an acquisition security right is a security right. Thus, all the recommendations governing security rights, including those on creation, third-party effectiveness (except as provided in recommendation 175), registration, enforcement and the law applicable to a security right, apply to acquisition security rights. The recommendations on priority also apply (except as provided in recommendations 176-182).

Third-party effectiveness and priority of an acquisition security right in consumer goods

175. The law should provide that an acquisition security right in consumer goods is effective against third parties upon its creation and, except as provided in recommendation 177, has priority as against a competing non-acquisition security right created by the grantor.

Priority of an acquisition security right in a tangible asset

176. The law should provide that, except as provided in recommendation 177:

Alternative A[**]

(a) An acquisition security right in a tangible asset other than inventory or consumer goods has priority as against a competing non-acquisition security right created by the grantor (even if a notice with respect to that security right was registered in the general security rights registry before registration of a notice with respect to the acquisition security right), provided that:

(i) The acquisition secured creditor retains possession of the asset; or

(ii) A notice with respect to the acquisition security right is registered in the general security rights registry not later than [specify a short time period, such as 20 or 30 days] after the grantor obtains possession of the asset;

(b) An acquisition security right in inventory has priority as against a competing non-acquisition security right created by the grantor (even if that security right became effective against third parties before the acquisition security right became effective against third parties), provided that:

(i) The acquisition secured creditor retains possession of the inventory; or

(ii) Before delivery of the inventory to the grantor:

a. A notice with respect to the acquisition security right is registered in the general security rights registry; and

b. A secured creditor with an earlier-registered non-acquisition security right created by the grantor in inventory of the same kind is notified by the acquisition secured creditor that it has or intends to acquire an acquisition security right. The notice must describe the

[**] A State may adopt alternative A or alternative B of recommendation 176.

inventory sufficiently to enable the non-acquisition secured creditor to identify the inventory that is the object of the acquisition security right;

(c) A notice, sent pursuant to subparagraph (b)(ii) b. of this recommendation, may cover acquisition security rights under multiple transactions between the same parties without the need to identify each transaction. The notice is sufficient only for security rights in tangible assets of which the grantor obtains possession within a period of [specify time, such as five years] after the notice is given.

Alternative B

an acquisition security right in a tangible assets other than consumer goods has priority as against a competing non-acquisition security right created by the grantor (even if a notice of that security right was registered in the general security rights registry before registration of a notice of the acquisition security right), provided that:

(a) The acquisition secured creditor retains possession of the asset; or

(b) A notice relating to the acquisition security right is registered in the general security rights registry not later than [a short time period, such as 20 or 30 days, to be specified] after the grantor obtains possession of the asset.

[*Note to the Commission: The Commission may wish to note that alternative A draws a distinction between tangible assets other than inventory and inventory, while alternative B does not make such a distinction. Such alternatives are provided to implement the decision of the Commission to parallel the language included in recommendation 189 so as to ensure functional equivalence of the unitary and the non-unitary approaches (see A/62/17 (Part I), para. 63). In view of the fact that retention of title and financial lease rights are typically non-possessory rights (and in any case the general recommendations about third-party effectiveness obtained by possession remain applicable, the Commission may wish to consider whether subparagraphs (a)(i) and (b)(i) of alternative A and subparagraph (a) of alternative B are necessary. The same question arises with respect to recommendation 189 below.*]

Priority of a security right registered in a specialized registry or noted on a title certificate

177. The law should provide that the priority of an acquisition security right under recommendation 176 does not override the priority of a security right or other right registered in a specialized registry or noted on a title certificate under recommendation 74 (chapter VII on the priority of a security right).

Priority between competing acquisition security rights

178. The law should provide that the priority between competing acquisition security rights is determined according to the general priority rules applicable to non-acquisition security rights, unless one of the acquisition security rights is an acquisition security right of a supplier that was made effective against third parties within the period specified in recommendation 176, in which case the supplier's

acquisition security right has priority as against all competing acquisition security rights.

Priority of an acquisition security right as against the right of a judgement creditor

179. The law should provide that an acquisition security right that is made effective against third parties within the period specified in recommendation 176 has priority as against the rights of an unsecured creditor that would otherwise have priority under recommendation 81 (chapter VII on the priority of a security right).

Priority of an acquisition security right in an attachment to immovable property as against an earlier registered encumbrance in the immovable property

180. The law should provide that an acquisition security right in a tangible asset that becomes an attachment to immovable property has priority as against third parties with existing rights in the immovable property (other than an encumbrance securing a loan financing the construction of the immovable property), provided that notice of the acquisition security right is registered in the immovable property registry not later than [a short time period, such as 20-30 days, to be specified] days after the asset becomes an attachment.

Priority of an acquisition security right in proceeds of tangible assets other than inventory or consumer goods

181. The law should provide that an acquisition security right in proceeds of tangible assets other than inventory or consumer goods has the same priority as the acquisition security right in those assets.

Priority of a security right in proceeds of inventory

182. The law should provide that a security right in proceeds of inventory has the same priority as the acquisition security right in that inventory, except where the proceeds take the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account or rights to receive the proceeds under an independent undertaking. However, this priority is conditional on the acquisition secured creditor notifying secured creditors that, before the proceeds arise, registered a notice with respect to a security right in assets of the same kind as the proceeds.

[*Note to the Commission: The Commission may wish to note that, to parallel the recommendation suggested in the note to recommendation 196, which does not draw a distinction between inventory and tangible assets other than inventory, an alternative to this recommendation could be added here (entitled "Priority of an acquisition security right in proceeds of a tangible asset") along the following lines:*

> *"The law should provide that, if an acquisition security right in tangible assets is effective against third parties, the security right in proceeds has the priority of a non-acquisition security right."*]

Acquisition security right as a security right in insolvency proceedings

183. The law should provide that, in the case of insolvency proceedings with respect to the debtor, the provisions that apply to security rights apply also to acquisition security rights.

[*Note to the Commission: The Commission may wish to note that this recommendation was moved from chapter XIV on the impact of insolvency on a security right to avoid the implication that the characterization of acquisition security rights as security rights is a matter of insolvency law (an implication that would be inconsistent with the UNCITRAL Insolvency Guide; see, for example, footnote 6 to recommendation 35 of the UNCITRAL Insolvency Guide). The Commission may wish to consider deleting this recommendation and adding to recommendation 174 on the equivalence of an acquisition security right to a security right the word "insolvency". As a result, the recommendations on security rights would apply to acquisition security rights within or outside insolvency (only the priority recommendations would be modified for acquisition security rights).*]

Option B: Non-unitary approach to acquisition financing*

Purpose (non-unitary approach)

The purpose of provisions on acquisition financing, including acquisition security rights, retention-of-title rights and financial lease rights, is:

(a) To recognize the importance and facilitate the use of acquisition financing as a source of affordable credit especially for small- and medium-sized businesses;

(b) To provide for equal treatment of all providers of acquisition financing; and

(c) To facilitate secured transactions in general by creating transparency with respect to acquisition financing.

Methods of acquisition financing

184. The law should provide that:

(a) The regime of acquisition security rights in the context of the non-unitary approach is identical to that adopted in the context of the unitary approach;

(b) All creditors, both suppliers and lenders, may acquire an acquisition security right in conformity with the regime governing acquisition security rights;

(c) Acquisition financing based on retention-of-title rights and financial lease rights may be provided in accordance with recommendation 185; and

(d) A lender may acquire the benefit of a retention-of-title right and a financial lease right through an assignment or subrogation.

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* A State may adopt option A (unitary approach to acquisition financing), i.e. recommendations 174-183, or option B (non-unitary approach to acquisition financing), i.e. recommendations 184-199.

Equivalence of a retention-of-title right and a financial lease right to an acquisition security right

185. The law should provide that the rules governing acquisition financing produce functionally equivalent economic results regardless of whether the creditor's right is a retention-of-title right, a financial lease right or an acquisition security right.

Effectiveness of a retention-of-title right and a financial lease right

186. The law should provide that a retention-of-title right or a financial lease right in a tangible asset is not effective unless the sale or lease agreement is concluded in or evidenced by a writing that in conjunction with the course of conduct between the parties indicates the seller's or the lessor's intent to retain ownership. The writing must exist not later than the time when the buyer or lessee obtains possession of the asset.

Right of buyer or lessee to create a security right

187. The law should provide that a buyer or lessee may create a security right in a tangible asset that is the object of a retention-of-title right or a financial lease right. The security right encumbers the asset only to the extent of the asset's value in excess of the amount owing to the seller or financial lessor.

Third-party effectiveness of a retention-of-title or financial lease right in consumer goods

188. The law should provide that a retention-of-title or a financial lease right in consumer goods is effective against third parties upon conclusion of the sale or lease provided that the right is evidenced in accordance with recommendation 186.

Third-party effectiveness of a retention-of-title right in a tangible asset

189. The law should provide that:

Alternative A[*]

(a) A retention-of-title right or a financial lease right in tangible asset other than inventory or consumer goods is effective against third parties only if:

(i) The seller or lessor retains possession of the asset; or

(ii) A notice relating to the right is registered in the general security rights registry not later than [a short time period, such as 20 or 30 days, to be specified] days after the buyer or lessee obtains possession of the asset;

(b) A retention-of-title right or a financial lease right in inventory is effective against third parties only if:

(i) The seller or lessor retains possession of the inventory; or

(ii) Before delivery of the inventory to the buyer or lessee:

[*] A State may adopt alternative A or alternative B of recommendation 189.

a. A notice relating to the right is registered in the general security rights registry; and

b. A secured creditor with an earlier registered non-acquisition security right created by the buyer or lessee in inventory of the same kind is notified by the seller or lessor of its intention to claim a retention-of-title right or a financial lease right. The notice should describe the inventory sufficiently to enable the secured creditor to identify the inventory that is the object of the retention-of-title right or the financial lease right;

(c) A notice sent pursuant to subparagraph (b)(ii) b. of this recommendation may cover retention-of-title rights and financial lease rights under multiple transactions between the same parties without the need to identify each transaction. The notice is effective only for rights in tangible assets of which the buyer or lessee obtains possession within a period of [a period of time, such as five years, to be specified] years after the notice is given.

Alternative B

a retention-of-title right or financial lease right in a tangible asset other than consumer goods is effective against third parties only if:

(a) The seller or lessor retains possession of the asset; or

(b) A notice relating to the right is registered in the general security rights registry not later than [a short time period, such as 20 or 30 days, to be specified] days after the buyer or lessee obtains possession of the asset.

The rule in this recommendation applies also to an acquisition security right in a tangible asset other than consumer goods.

[*Note to the Commission: The Commission may wish to note that alternative A of this recommendation draws a distinction between inventory and tangible assets other than inventory, while alternative B does not draw such a distinction.*]

One registration sufficient

190. The law should provide that registration of a single notice in the general security rights registry is sufficient to achieve third-party effectiveness of a retention-of-title right or a financial lease right under multiple transactions between the same parties, whether concluded before or after the registration, which involve tangible assets that fall within the description contained in the notice. The provisions on the registry system apply, with appropriate modifications as to terminology, to the registration of a retention-of-title right and a financial lease right.

Effect of failure to achieve third-party effectiveness of a retention-of-title right or a financial lease right

191. The law should provide that, if a retention-of-title right or a financial lease right is not effective against third parties, ownership of the asset as against third

parties passes to the buyer or lessee, and the seller or lessor has a security right in the asset subject to the recommendations applicable to security rights.

Third-party effectiveness of a retention-of-title or financial lease right in an attachment to immovable property

192. The law should provide that a retention-of-title right or a financial lease right in a tangible asset that becomes an attachment to immovable property is effective against third parties with rights in the immovable property that are registered in the immovable property registry only if it is registered in the immovable property registry not later than [a short time period, such as 20-30 days, to be specified] days after the asset becomes an attachment.

Existence of a security right in proceeds of a tangible asset subject to a retention-of-title right or financial lease right

193. The law should provide that a seller or lessor with a retention-of-title right or financial lease right in a tangible asset has a security right in proceeds of the asset.

Third-party effectiveness of a security right in proceeds of a tangible asset subject to a retention-of-title right or financial lease right

194. The law should provide that:

(a) A security right in proceeds referred to in recommendation 193 is effective against third parties only if the proceeds are described in a generic way in the registered notice by which the retention-of-title right or financial lease right was made effective against third parties or the proceeds consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account;

(b) If the proceeds are not described in a generic way in the registered notice or do not consist of the types of asset referred to in subparagraph (a) of this recommendation, the security right in the proceeds is effective against third parties for [a short period of time to be specified] days after the proceeds arise and continuously thereafter, if it was made effective against third parties by one of the methods referred to in recommendation 32 or 34 (chapter V on the third-party effectiveness of a security right) before the expiry of that time period.

Priority of a security right in proceeds of a tangible asset other than inventory or consumer goods

195. The law should provide that, if a retention-of-title right or financial lease right is effective against third parties, the security right in proceeds referred to in recommendation 193 has priority as against another security right in the same assets.

Priority of a security right in proceeds of inventory

196. The law should provide that, if a retention-of-title right or financial lease right is effective against third parties, the security right in proceeds of inventory referred to in recommendation 193 has the same priority as a retention-of-title or financial lease right in that inventory, except where the proceeds take the form of receivables, negotiable instruments, rights to payment of funds credited to a bank account and

rights to receive the proceeds under an independent undertaking. However, this priority is conditional on the seller or lessor notifying secured creditors that have registered a notice with respect to a security right in assets of the same kind as the proceeds before the proceeds arise.

[*Note to the Commission: The Commission may wish to recall that, at its fortieth session (first part), it decided that a second alternative should be prepared with respect to the third-party effectiveness of a retention-of-title right and a financial lease right that would not make a distinction between inventory and assets other than inventory as to the original encumbered assets (see A/62/17 (Part I), paras. 63 and 89-90). These alternatives are reflected in recommendation 189.*

The Commission may wish to consider whether, to parallel the alternatives in recommendation 189, an alternative to recommendations 195 and 196 should be made available (entitled "Priority of a security right in proceeds of a tangible asset") along the following lines:

> *"The law should provide that, if a retention-of-title right or financial lease right in tangible assets is effective against third parties, the security right in proceeds referred to in recommendation 193 has the priority of a non-acquisition security right if the security right in the proceeds is effective against third parties under recommendation 194.*
>
> *"The law should provide that the rule in the preceding recommendation applies also to the proceeds of a tangible asset subject to an acquisition security right."*

The Commission may wish to note that these recommendations provide that the security right in the proceeds of an asset that was subject to a retention-of-title or financial lease right has the priority of a non-acquisition security right (i.e. not a super-priority). This approach, which is in line with recommendation 196, is intended to avoid a negative impact on receivables financing and inventory financing, and is consistent with the approach taken in most jurisdictions in which retention of title is used.]

Enforcement of a retention-of-title right or a financial lease right

197. The law should provide that:

(a) Rules for the post-default enforcement of a retention-of-title right or a financial lease right in a tangible asset should deal with:

(i) The manner in which the seller or lessor may obtain possession of the asset;

(ii) Whether the seller or lessor is required to dispose of the asset and, if so, how;

(iii) Whether the seller or lessor may retain any surplus; and

(iv) Whether the seller or lessor has a claim for any deficiency against the buyer or lessee;

(b) The regime that applies to the post-default enforcement of a security right applies to the post-default enforcement of a retention-of-title right or a

financial lease right except to the extent necessary to preserve the coherence of the regime applicable to sale and lease.

Retention-of-title or financial lease right in insolvency proceedings

198. The law should provide that, in the case of insolvency proceedings with respect to the debtor,

Alternative A[*]

the provisions that apply to security rights apply also to retention-of-title rights and financial lease rights.

Alternative B

the provisions of the law of the enacting State that apply to ownership rights of third parties apply also to retention-of-title rights and financial lease rights.

[*Note to the Commission: The Commission may wish to note that this recommendation was moved from chapter XIV on the impact of insolvency on a security right to avoid the implication that the characterization of acquisition security rights as security rights or as ownership rights is a matter of insolvency law (an implication that would be inconsistent with the UNCITRAL Insolvency Guide; see, for example, footnote 6 to recommendation 35 of the UNCITRAL Insolvency Guide).*

The Commission may also wish to note that the commentary will explain that such characterization is a matter of secured transactions law or general property law. The commentary will also explain that insolvency law defers to secured transactions law on these matters. The commentary will also explain that an acquisition security right is to be treated as a security right in the context of both the unitary and the non-unitary approach.

The commentary of chapter XIV on the impact of insolvency on a security right will explain that, under the UNCITRAL Insolvency Guide, if a retention-of-title right or financial lease right is, under law other than insolvency law, a security right, the recommendations of the UNCITRAL Insolvency Guide dealing with security rights apply. If a retention-of-title right or financial lease right is, under law other than insolvency law, an ownership right, the recommendations of the UNCITRAL Insolvency Guide dealing with third-party-owned assets apply.]

Law applicable to a retention-of-title right or a financial lease right

199. The law should provide that the conflict-of-laws provisions that apply to security rights apply also to retention-of-title rights and financial lease rights.

[*] A State may adopt alternative A or alternative B of recommendation 198.

XII. Conflict of laws*

Purpose

The purpose of conflict-of-laws provisions is to determine the law applicable to: the creation, third-party effectiveness and priority of a security right; and the pre- and post-default rights and obligations of the grantor, secured creditor and third parties.[33]

A. General recommendations

Law applicable to a security right in tangible assets

200. The law[34] should provide that, except as provided in recommendations 201-204 and 208, the law applicable to the creation, third-party effectiveness and priority of a security right in a tangible asset is the law of the State in which the asset is located.

201. The law should provide that the law applicable to the issues mentioned in recommendation 198 with respect to a security right in a tangible asset of a type ordinarily used in more than one State is the law of the State in which the grantor is located.

202. The law should provide that, if a tangible asset is subject to registration in a specialized registry or notation on a title certificate providing for registration or notation of a security right, the law applicable to issues mentioned in recommendation 200 is the law of the State under whose authority the registry is maintained or the title certificate is issued.

203. The law should provide that the law applicable to the priority of a security right in a tangible asset made effective against third parties by possession of a negotiable document as against a competing security right made effective against third parties by another method is the law of the State in which the document is located.

Law applicable to a security right in tangible assets in transit or to be exported

204. The law should provide that a security right in a tangible asset (other than a negotiable instrument or a negotiable document) in transit or to be exported from the State in which it is located at the time of the creation of the security right may be created and made effective against third parties under the law of the State of the initial location of the asset as provided in recommendation 200 or under the law of the State of its ultimate destination, provided that the asset reaches that State within [a short period of time to be specified] days after the time of creation of the security right.

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* The recommendations on the conflict of laws were prepared in close cooperation with the Permanent Bureau of the Hague Conference on Private International Law.

[33] Conflict-of-laws issues relating to acquisition financing and insolvency are addressed in chapters XI and XIV respectively.

[34] "Law" in this chapter means the secured transactions law or other law in which a State may include conflict-of-laws provisions.

Law applicable to a security right in intangible assets

205. The law should provide that the law applicable to the creation, effectiveness against third parties and priority of a security right in an intangible asset is the law of the State in which the grantor is located.

Law applicable to receivables arising from a sale, lease or security agreement relating to immovable property

206. The law should provide that the law applicable to the creation, third-party effectiveness and priority of a security right in a receivable arising from a sale, lease or security agreement relating to immovable property is the law of the State in which the assignor is located. However, the law applicable to a priority conflict involving the right of a competing claimant that is registered in an immovable property registry is the law of the State under whose authority the registry is maintained. The rule in the preceding sentence applies only if registration is relevant under that law to the priority of a security right in the receivable.

Law applicable to a security right in a right to payment of funds credited to a bank account

207. The law should provide that the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as rights and duties of the depositary bank with respect to the security right, is

Alternative A[*]

the law of the State in which the bank that maintains the bank account has its place of business. If the bank has places of business in more than one State, reference should be made to the place where the branch maintaining the account is located.

Alternative B

the law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, the law of the State determined pursuant to the preceding sentence applies only if the depositary bank has, at the time of the conclusion of the account agreement, an office in that State that is engaged in the regular activity of maintaining bank accounts. If the applicable law is not determined pursuant to the preceding two sentences, the applicable law is to be determined pursuant to default rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.[35]

This recommendation is subject to the exception provided in recommendation 208.

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[*] A State may adopt alternative A or alternative B of recommendation 207.

[35] A State that adopts alternative B has to also adopt recommendations 223 and 224.

Law applicable to the third-party effectiveness of a security right in specified types of asset by registration

208. The law should provide that, if the State in which the grantor is located recognizes registration as a method of achieving effectiveness against third parties of a security right in a negotiable instrument or a right to payment of funds credited to a bank account, the law of the State in which the grantor is located is the law applicable to the issue whether third-party effectiveness has been achieved by registration under the laws of that State.

Law applicable to a security right in the right to receive the proceeds under an independent undertaking

209. The law should provide that the law of the State specified in an independent undertaking of a guarantor/issuer, confirmer or nominated person is the law applicable to:

(a) The rights and duties of the guarantor/issuer, confirmer or nominated person that has received a request for an acknowledgement or that has or may pay or otherwise give value under an independent undertaking;

(b) The right to enforce a security right in the right to receive the proceeds under the independent undertaking against the guarantor/issuer, confirmer or nominated person; and

(c) Except as provided in recommendation 209, the third-party effectiveness and priority of a security right in the right to receive the proceeds under the independent undertaking.

210. If the applicable law is not specified in the independent undertaking of the guarantor/issuer or confirmer, the law applicable to the issues referred to in recommendation 209 is the law of the State of the location of the branch or office of the guarantor/issuer or confirmer indicated in the independent undertaking. However, in the case of a nominated person, the applicable law is the law of the State of the location of the nominated person's branch or office that has or may pay or otherwise give value under the independent undertaking.

211. The law should provide that the law applicable to the creation and third-party effectiveness of a security right in a receivable, negotiable instrument or other claim, the payment or other performance of which is secured by an independent undertaking, is also the law applicable to the issue whether a security right in the right to receive the proceeds under the independent undertaking is created and made effective against third parties automatically as contemplated in recommendations 25 and 48 (chapter IV on the creation of a security right).

Law applicable to a security right in proceeds

212. The law should provide that:

(a) The law applicable to the creation of a security right in proceeds is the law applicable to the creation of the security right in the original encumbered asset from which the proceeds arose; and

(b) The law applicable to the third-party effectiveness and priority of a security right in proceeds is the law applicable to the third-party effectiveness and priority of a security right in an asset of the same kind as the proceeds.

Law applicable to the rights and obligations of the grantor and the secured creditor

213. The law should provide that the law applicable to the mutual rights and obligations of the grantor and the secured creditor arising from their security agreement is the law chosen by them and, in the absence of a choice of law, by the law governing the security agreement.

Law applicable to the rights and obligations of third-party obligors and secured creditors

214. The law should provide that the law applicable to a receivable, negotiable instrument or negotiable document also is the law applicable to:

(a) The relationship between the debtor of the receivable and the assignee of the receivable, between an obligor under a negotiable instrument and the holder of a security right in the instrument or between the issuer of a negotiable document and the holder of a security right in the document;

[*Note to the Commission: The Commission may wish to delete the reference to the law applicable to the relationship between the issuer of a negotiable document and the holder of a security right in the document. For the secured transactions law to provide that this relationship is subject to the law of the State governing the negotiable document may result in an inconsistency with the approaches currently taken in the transport laws of different States. The matter may be better left to other law.*]

(b) The conditions under which an assignment of the receivable, a security right in the negotiable instrument or a security right in the negotiable document may be invoked against the debtor of the receivable, the obligor on the negotiable instrument or the issuer of the negotiable document (including whether an anti-assignment agreement may be asserted by the debtor of the receivable, the obligor or the issuer); and

(c) Whether the obligations of the debtor of the receivable, the obligor on the negotiable instrument or the issuer of the negotiable document have been discharged.

Law applicable to enforcement of a security right

215. The law should provide that, subject to recommendation 220, the law applicable to issues relating to the enforcement of a security right:

(a) In a tangible asset is the law of the State where enforcement takes place; and

(b) In an intangible asset is the law applicable to the priority of the security right.

Meaning of "location" of the grantor

216. The law should provide that, for the purposes of the conflict-of-laws provisions, the grantor is located in the State in which it has its place of business. If the grantor has a place of business in more than one State, the grantor's place of business is that place where the central administration of the grantor is exercised. If the grantor does not have a place of business, reference is to be made to the habitual residence of the grantor.

Relevant time for determining location

217. The law should provide that:

(a) Except as provided in subparagraph (b) of this recommendation, references to the location of the assets or of the grantor in the conflict-of-laws provisions refer, for creation issues, to the location at the time of the putative creation of the security right and, for third-party effectiveness and priority issues, to the location at the time the issue arises;

(b) If the rights of all competing claimants in an encumbered asset were created and made effective against third parties before a change in location of the asset or the grantor, references in the conflict-of-laws provisions to the location of the asset or of the grantor refer, with respect to third-party effectiveness and priority issues, to the location prior to the change in location.

Exclusion of renvoi

218. The law should provide that a reference in the conflict-of-laws provisions to "the law" of another State as the law applicable to an issue refers to the law in force in that State other than its conflict-of-laws provisions.

Public policy and internationally mandatory rules

219. The law should provide that:

(a) The application of the law determined under the conflict-of-laws provisions may be refused only if the effects of its application would be manifestly contrary to the public policy of the forum;

(b) The conflict-of-laws provisions do not prevent the application of those provisions of the law of the forum which, irrespective of conflict-of-laws provisions, must be applied even to international situations; and

(c) Subparagraphs (a) and (b) of this recommendation do not permit the application of the provisions of the law of the forum to the third-party effectiveness and priority of a security right.

Impact of commencement of insolvency proceedings on the law applicable to security rights

220. The law should provide that the commencement of insolvency proceedings does not displace the conflict-of-laws provisions that determine the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right (and, in the context of the non-unitary approach, a retention-of-title right and financial lease right). However, this provision should be subject to the effects on

such issues of the application of the insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) to issues such as avoidance, treatment of secured creditors, ranking of claims or distribution of proceeds.[36]

[*Note to the Commission: The Commission may wish to note that this recommendation was moved from chapter XIV on the impact of insolvency on a security right and revised in order to avoid inconsistencies with the UNCITRAL Insolvency Guide, which deals with the law applicable to the validity and effectiveness of rights and claims, but not with the law applicable to the general priority or the enforcement of a security right. The commentary will explain that the first sentence of this recommendation introduces a generally acceptable conflict-of-laws rule, which is in line with the UNCITRAL Insolvency Guide as the second sentence preserves the application of the lex fori concursus.*[37] *In this context, the commentary will refer to the commentary of chapter XIV on the impact of insolvency on a security right explaining the conflict-of-laws recommendations of the UNCITRAL Insolvency Guide.*]

B. Special recommendations when the applicable law is the law of a multi-unit State

221. The law should provide that in situations in which the law applicable to an issue is the law of a multi-unit State subject to recommendation 222, references to the law of a multi-unit State are to the law of the relevant territorial unit (as determined on the basis of the location of the grantor or of an encumbered asset or otherwise under the conflict-of-laws provisions) and, to the extent applicable in that unit, to the law of the multi-unit State itself.

222. The law should provide that if, under its conflict-of laws provisions, the applicable law is that of a multi-unit State or one of its territorial units, the internal conflict-of laws provisions in force in the multi-unit State or territorial unit determine whether the substantive provisions of law of the multi-unit State or of a particular territorial unit of the multi-unit State apply.

223. The law should provide that, if the account holder and the depositary bank have chosen the law of a specified territorial unit of a multi-unit State as the law applicable to the account agreement:

(a) The references to “State” in the first sentence of recommendation 207 (alternative B) are to the territorial unit;

(b) The references to “that State” in the second sentence of recommendation 207 (alternative B) are to the multi-unit State itself.

224. The law should provide that the law of a territorial unit is the applicable law if:

(a) Under recommendations 207 (alternative B) and 223, the designated law is that of a territorial unit of a multi-unit State;

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[36] See recommendation 31 of the UNCITRAL Insolvency Guide.

[37] See UNCITRAL Insolvency Guide, part two, para. 88, and recommendation 34, which provides that additional exceptions could be made to that principle as long as they are clearly set forth or noted in the insolvency law.

(b) Under the law of that State, the law of a territorial unit is the law applicable only if the depositary bank has an office within that territorial unit which satisfies the condition specified in the second sentence of recommendation 207 (alternative B); and

(c) The provision described in subparagraph (b) of this recommendation is in force at the time the security right in the bank account is created.[38]

XIII. Transition

Purpose

The purpose of provisions on transition is to provide a fair and efficient transition to the law from the regime in force before the effective date of the law.

Effective date

225. The law should specify either a date subsequent to its enactment on which it comes into force (the "effective date") or a mechanism by which the effective date may be determined. From its effective date, the law applies to all transactions within its scope, whether entered into before or after that date, except as provided below.

Inapplicability of the law to actions commenced before the effective date

226. The law should provide that it does not apply to a matter that is the subject of litigation or alternative binding dispute resolution proceedings that were commenced before the effective date. If enforcement of a security right has commenced before the effective date, the enforcement may continue under the law in force before the effective date ("prior law").

[*Note to the Commission: The Commission may wish to consider whether initiation of a post-default remedy before the effective date of the new law should result in the application of the entire prior law to enforcement. If so, use of the word "must" rather than "may" is more appropriate.*]

Creation of a security right

227. The law should provide that prior law determines whether a security right was created before the effective date.

Third-party effectiveness of a security right

228. The law should provide that a security right that is effective against third parties under prior law remains effective against third parties until the earlier of:

(a) The time it would cease to be effective against third parties under prior law; and

(b) The expiration of a period of [time period to be specified] months after the effective date ("the transition period").

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[38] Only a State that adopts recommendation 207 (alternative B) needs to adopt recommendations 223 and 224.

If the requirements for third-party effectiveness under this law are satisfied before third-party effectiveness would have ceased under the preceding sentence, third-party effectiveness is continuous.

Priority of a security right

229. Subject to recommendations 230 and 231, the law should provide that it governs the priority of a security right. The time when a security right referred to in recommendation 228 was made effective against third parties or became the subject of a registered notice under prior law is the time to be used in determining the priority of that right.

230. The law should provide that the priority of a security right is determined by prior law if:

(a) The security right and the rights of all competing claimants arose before the effective date; and

(b) The priority status of none of these rights has changed since the effective date.

231. The law should provide that the status of a security right has changed if:

(a) It was effective against third parties on the effective date in accordance with recommendation 228 and later ceased to be effective against third parties; or

(b) It was not effective against third parties on the effective date and later became effective against third parties.

[*Note to the Commission: The Commission may wish to consider whether this recommendation should be deleted because it might not sufficiently explain the meaning of the word "status" and might even be misleading. The insertion of the word "priority" before the word "status" in this recommendation might be sufficient to address this matter, and the commentary could elaborate further.*]

XIV. The impact of insolvency on a security right

A. *UNCITRAL Legislative Guide on Insolvency Law*:[39] definitions and recommendations

Definitions

12. (b) "Assets of the debtor": property, rights and interests of the debtor, including rights and interests in property, whether or not in the possession of the debtor, tangible or intangible, movable or immovable, including the debtor's interests in encumbered assets or in third-party-owned assets;

12. (r) "Financial contract": any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above

[39] United Nations publication, E.05.V.10.

entered into in financial markets and any combination of the transactions mentioned above;

[*Note to the Commission: The Commission may wish to consider whether the definitions of the terms "financial contract" and "netting agreement" (drawn from United Nations Assignment Convention, article 5, subparagraphs (k) and (l) and reproduced in the Secured Transactions Guide) should also be reproduced here.*]

12. (x) "*Lex fori concursus*": the law of the State in which the insolvency proceedings are commenced;

12. (y) "*Lex rei sitae*": the law of the State in which the asset is situated;

12. (z) "Netting": the setting-off of monetary or non-monetary obligations under financial contracts;

12. (aa) "Netting agreement": a form of financial contract between two or more parties that provides for one or more of the following:

(i) The net settlement of payments due in the same currency on the same date whether by novation or otherwise;

(ii) Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; or

(iii) The set-off of amounts calculated as set forth in subparagraph (ii) of this definition under two or more netting agreements.[40]

12. (dd) "Party in interest": any party whose rights, obligations or interests are affected by insolvency proceedings or particular matters in the insolvency proceedings, including the debtor, the insolvency representative, a creditor, an equity holder, a creditor committee, a government authority or any other person so affected. It is not intended that persons with remote or diffuse interests affected by the insolvency proceedings would be considered to be a party in interest;

12. (ff) "Preference": a transaction which results in a creditor obtaining an advantage or irregular payment;

12. (gg) "Priority": the right of a claim to rank ahead of another claim where that right arises by operation of law;

12. (hh) "Priority claim": a claim that will be paid before payment of general unsecured creditors;

12. (ii) "Protection of value": measures directed at maintaining the economic value of encumbered assets and third-party-owned assets during the insolvency proceedings (in some jurisdictions referred to as "adequate protection"). Protection may be provided by way of cash payments, provision of security interests over alternative or additional assets or by other means as determined by a court to provide the necessary protection;

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[40] United Nations Convention on the Assignment of Receivables in International Trade (United Nations publication, Sales No. E.04.V.14), article 5, subparagraph (1).

12. (pp) “Security interest”: a right in an asset to secure payment or other performance of one or more obligations.

Recommendations

[*Note to the Commission: The Commission may wish to note that, in order to ensure that all relevant recommendations of the UNCITRAL Insolvency Guide are reproduced in this chapter, recommendations (34), (40-45), (63), (73), (79), (81)-(85), (87), (92), (146)-(149) and (178) of the UNCITRAL Insolvency Guide have been included below.*]

Key objectives of an efficient and effective insolvency law

(1) In order to establish and develop an effective insolvency law, the following key objectives should be considered:

(a) Provide certainty in the market to promote economic stability and growth;

(b) Maximize value of assets;

(c) Strike a balance between liquidation and reorganization;

(d) Ensure equitable treatment of similarly situated creditors;

(e) Provide for timely, efficient and impartial resolution of insolvency;

(f) Preserve the insolvency estate to allow equitable distribution to creditors;

(g) Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and

(h) Recognize existing creditors’ rights and establish clear rules for ranking of priority claims.

(4) The insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable.

(7) In order to design an effective and efficient insolvency law, the following common features should be considered:

(a)-(d) …

(e) Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative, and where the protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings;

(f)-(r) …

Law applicable to validity and effectiveness of rights and claims

(30) The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

Law applicable in insolvency proceedings: *lex fori concursus*

(31) The insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

(a)-(i) …

(j) Treatment of secured creditors;

(k)-(n) …

(o) Ranking of claims;

(p)-(s) …

Exceptions to the application of the law of the insolvency proceedings

…

(34) Any exceptions additional to recommendations 32 and 33 should be limited in number and be clearly set forth or noted in the insolvency law.

Assets constituting the insolvency estate

(35) The insolvency law should specify that the estate should include:

(a) Assets of the debtor,[41] including the debtor's interest in encumbered assets and in third-party-owned assets;

(b) Assets acquired after commencement of the insolvency proceedings; and

(c) …

Provisional measures[42]

(39) The insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor[43] or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings,[44] including:

(a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;

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[41] Ownership of assets would be determined by reference to the relevant applicable law, where the term "assets" is defined broadly to include property, rights and interest of the debtor, including the debtor's rights and interests in third-party-owned assets.

[42] These articles follow the corresponding articles of the UNCITRAL Model Law on Cross-Border Insolvency, see article 19 (see annex III of the *UNCITRAL Insolvency Guide*).

[43] The reference to assets in paragraphs (a)-(c) is intended to be limited to assets that would be part of the insolvency estate once proceedings commence.

[44] The insolvency law should indicate the time of effect of an order for provisional measures, for example, at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time (see para. 44 of the *UNCITRAL Insolvency Guide*).

(b)-(d) …

Indemnification in connection with provisional measures

(40) The insolvency law may provide the court with the power to:

(a) Require the applicant for provisional measures to provide indemnification and, where appropriate, to pay costs or fees; or

(b) Impose sanctions in connection with an application for provisional measures.

Balance of rights between the debtor and insolvency representative

(41) The insolvency law should clearly specify the balance of the rights and obligations between the debtor and any insolvency representative appointed as a provisional measure. Between the time an application for commencement of insolvency proceedings is made and commencement of those proceedings, the debtor is entitled to continue to operate its business and to use and dispose of assets in the ordinary course of business, except to the extent restricted by the court.

Notice

(42) The insolvency law should specify that, unless the court limits or dispenses with the need to provide notice, appropriate notice is to be given to those parties in interest affected by:

(a) An application or court order for provisional measures (including an application for review and modification or termination); and

(b) A court order for additional measures applicable on commencement, unless the court limits or dispenses with the need to provide notice.

Ex parte provisional measures

(43) The insolvency law should specify that, where the debtor or other party in interest affected by a provisional measure is not given notice of the application for that provisional measure, the debtor or other party in interest affected by the provisional measures has the right, upon urgent application, to be heard promptly[45] on whether the relief should be continued.

Modification or termination of provisional measures

(44) The insolvency law should specify that the court, at its own motion or at the request of the insolvency representative, the debtor, a creditor or any other person affected by the provisional measures, may review and modify or terminate those measures.

Termination of provisional measures

(45) The insolvency law should specify that provisional measures terminate when:

(a) An application for commencement is denied;

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[45] Any time limit included in the insolvency law should be short in order to prevent the loss of value of the debtor's business.

(b) An order for provisional measures is successfully challenged under recommendation 43; and

(c) The measures applicable on commencement take effect, unless the court continues the effect of the provisional measures.

Measures applicable on commencement

(46) The insolvency law should specify that, on commencement of insolvency proceedings:[46]

(a) Commencement or continuation of individual actions or proceedings[47] concerning the assets of the debtor, and the rights, obligations or liabilities of the debtor are stayed;

(b) Actions to make security interests effective against third parties and to enforce security interests are stayed;[48]

(c) Execution or other enforcement against the assets of the estate is stayed;

(d) The right of a counterparty to terminate any contract with the debtor is suspended;[49] and

(e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.[50]

Duration of measures automatically applicable on commencement

(49) The insolvency law should specify that the measures applicable on commencement of insolvency proceedings remain effective throughout those proceedings until:

(a) The court grants relief from the measures;[51]

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[46] These measures would generally be effective as at the time of the making of the order for commencement.

[47] See UNCITRAL Model Law on Cross-Border Insolvency, article 20 (see annex III of the *UNCITRAL Insolvency Guide*). It is intended that the individual actions referred to in subparagraph (a) of recommendation 46 would also cover actions before an arbitral tribunal. It may not always be possible, however, to implement the automatic stay of arbitral proceedings, such as where the arbitration does not take place in the State but in a foreign location.

[48] If law other than the insolvency law permits those security interests to be made effective within certain specified time periods, it is desirable that the insolvency law recognize those periods and permit the interest to be made effective where the commencement of insolvency proceedings occurs before expiry of the specified time period. Where law other than the insolvency law does not include such time periods, the stay applicable on commencement would operate to prevent the security interest being made effective. (For further discussion see para. 32 of the *UNCITRAL Insolvency Guide*, and the UNCITRAL Legislative Guide on Secured Transactions.)

[49] See *UNCITRAL Insolvency Guide*, paragraphs 114-119. This recommendation is not intended to preclude the termination of a contract if the contract provides for a termination date that happens to fall after the commencement of insolvency proceedings.

[50] The limitation on the right to transfer, encumber or otherwise dispose of assets of the estate may be subject to an exception in those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

[51] Relief should be granted on the grounds included in recommendation 51 of the *UNCITRAL*

(b) In reorganization proceedings, a reorganization plan becomes effective;[52] or

(c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires,[53] unless it is extended by the court for a further period on a showing that:

(i) An extension is necessary to maximize the value of assets for the benefit of creditors; and

(ii) The secured creditor will be protected against diminution of the value of the encumbered asset in which it has a security interest.

Protection from diminution of the value of encumbered assets

(50) The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the asset in which it has a security interest. The court may grant appropriate measures of protection that may include:

(a) Cash payments by the estate;

(b) Provision of additional security interests; or

(c) Such other means as the court determines.

Relief from measures applicable on commencement

(51) The insolvency law should specify that a secured creditor may request the court to grant relief from the measures applicable on commencement of insolvency proceedings on grounds that may include that:

(a) The encumbered asset is not necessary to a prospective reorganization or sale of the debtor's business;

(b) The value of the encumbered asset is diminishing as a result of the commencement of insolvency proceedings and the secured creditor is not protected against that diminution of value; and

(c) In reorganization, a plan is not approved within any applicable time limits.

Power to use and dispose of assets of the estate

(52) The insolvency law should permit:

(a) The use and disposal of assets of the estate (including encumbered assets) in the ordinary course of business, except cash proceeds; and

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Insolvency Guide.

[52] A plan may become effective upon approval by creditors or following confirmation by the court, depending upon the requirements of the insolvency law (see *UNCITRAL Insolvency Guide*, chap. IV, paras. 54 and following).

[53] It is intended that the stay should apply to secured creditors only for a short period of time, such as between 30 and 60 days, and that the insolvency law should clearly state the period of application.

(b) The use and disposal of assets of the estate (including encumbered assets) outside the ordinary course of business, subject to the requirements of recommendations 55 and 58.

Further encumbrance of encumbered assets

(53) The insolvency law should specify that encumbered assets may be further encumbered, subject to the requirements of recommendations 65-67.

Use of third-party-owned assets

(54) The insolvency law should specify that the insolvency representative may use an asset owned by a third party and in the possession of the debtor provided specified conditions are satisfied, including:

(a) The interests of the third party will be protected against diminution in the value of the asset; and

(b) The costs under the contract of continued performance of the contract and use of the asset will be paid as an administrative expense.

Ability to sell assets of the estate free and clear of encumbrances and other interests

(58) The insolvency law should permit the insolvency representative to sell assets that are encumbered or subject to other interest free and clear of that encumbrance and other interest, outside the ordinary course of business, provided that:

(a) The insolvency representative gives notice of the proposed sale to the holders of encumbrances or other interests;

(b) The holder is given the opportunity to be heard by the court where they object to the proposed sale;

(c) Relief from the stay has not been granted; and

(d) The priority of interests in the proceeds of sale of the asset is preserved.

Use of cash proceeds

(59) The insolvency law should permit the insolvency representative to use and dispose of cash proceeds if:

(a) The secured creditor with a security interest in those cash proceeds consents to such use or disposal; or

(b) The secured creditor was given notice of the proposed use or disposal and an opportunity to be heard by the court; and

(c) The interests of the secured creditor will be protected against diminution in the value of the cash proceeds.

Burdensome assets

(62) The insolvency law should permit the insolvency representative to determine the treatment of any asset that is burdensome to the estate. In particular, the insolvency law may permit the insolvency representative to relinquish a burdensome

asset following the provision of notice to creditors and the opportunity for creditors to object to the proposed action, except that where a secured claim exceeds the value of the encumbered asset, and the asset is not required for a reorganization or sale of the business as a going concern, the insolvency law may permit the insolvency representative to relinquish the asset to the secured creditor without notice to other creditors.

Attracting and authorizing post-commencement finance

(63) The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of the value of the estate. The insolvency law may require the court to authorize or creditors to consent to the provision of post-commencement finance.

Security for post-commencement finance

(65) The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on an unencumbered asset, including an after-acquired asset, or a junior or lower priority security interest on an already encumbered asset of the estate.

(66) The law[54] should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation 67.

(67) The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

(a) The existing secured creditor was given the opportunity to be heard by the court;

(b) The debtor can prove that it cannot obtain the finance in any other way; and

(c) The interests of the existing secured creditor will be protected.[55]

Effect of conversion on post-commencement finance

(68) The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation.[56]

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[54] This rule may be in a law other than the insolvency law, in which case the insolvency law should note the existence of the provision.

[55] See *UNCITRAL Insolvency Guide*, paragraphs 63-69.

[56] The same order of priority may not necessarily be recognized. For example, post-commencement finance may rank in priority after administrative claims relating to the costs of the liquidation.

Automatic termination and acceleration clauses

(70) The insolvency law should specify that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:

(a) An application for commencement, or commencement, of insolvency proceedings;

(b) The appointment of an insolvency representative.[57]

(71) The insolvency law should specify the contracts that are exempt from the operation of recommendation 70, such as financial contracts, or subject to special rules, such as labour contracts.

Continuation or rejection

(72) The insolvency law should specify that the insolvency representative may decide to continue the performance of a contract of which it is aware where continuation would be beneficial to the insolvency estate.[58] The insolvency law should specify that:

(a) The right to continue applies to the contract as a whole; and

(b) The effect of continuation is that all terms of the contract are enforceable.

(73) The insolvency law may permit the insolvency representative to decide to reject a contract.[59] The insolvency law should specify that the right to reject applies to the contract as a whole.

Continuation of contracts where the debtor is in breach

(79) The insolvency law should specify that where the debtor is in breach of a contract the insolvency representative can continue the performance of that contract, provided the breach is cured, the non-breaching counterparty is substantially returned to the economic position it was in before the breach and the estate is able to perform under the continued contract.

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[57] This recommendation would apply only to those contracts where such clauses could be overridden (see commentary of the *UNCITRAL Insolvency Guide*, paras. 143-145, on exceptions) and is not intended to be exclusive, but to establish a minimum: the court should be able to examine other contractual clauses that would have the effect of terminating a contract on the occurrence of similar events.

[58] Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation, unless the contract has a termination date that happens to fall after the commencement of insolvency proceedings.

[59] An alternative to providing a power to reject contracts is the approach of those jurisdictions which provide that performance of a contract simply ceases unless the insolvency representative decides to continue its performance.

Performance prior to continuation or rejection

(80) The insolvency law should specify that the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:

(a) If the counterparty has performed the contract the amount of the administrative expense should be the contractual price of the performance; or

(b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with subparagraph (a).

Damages for subsequent breach of a continued contract

(81) The insolvency law should specify that where a decision is made to continue performance of a contract, damages for the subsequent breach of that contract should be payable as an administrative expense.

Damages arising from rejection

(82) The insolvency law should specify that any damages arising from the rejection of a pre-commencement contract would be determined in accordance with applicable law and should be treated as an ordinary unsecured claim. The insolvency law may limit claims relating to the rejection of a long-term contract.

Assignment of contracts

(83) The insolvency law may specify that the insolvency representative can decide to assign a contract, notwithstanding restrictions in the contract, provided the assignment would be beneficial to the estate.

(84) Where the counterparty objects to assignment of a contract, the insolvency law may permit the court to nonetheless approve the assignment provided:

(a) The insolvency representative continues the contract;

(b) The assignee can perform the assigned contractual obligations;

(c) The counterparty is not substantially disadvantaged by the assignment; and

(d) The debtor’s breach under the contract is cured before assignment.

(85) The insolvency law may specify that, where the contract is assigned, the assignee will be substituted for the debtor as the contracting party with effect from the date of the assignment and the estate will have no further liability under the contract.

Avoidable transactions[60]

(87) The insolvency law should include provisions that apply retroactively and are designed to overturn transactions, involving the debtor or assets of the estate, and that have the effect of either reducing the value of the estate or upsetting the principle of equitable treatment of creditors. The insolvency law should specify the following types of transaction as avoidable:

(a) Transactions intended to defeat, delay or hinder the ability of creditors to collect claims where the effect of the transaction was to put assets beyond the reach of creditors or potential creditors or to otherwise prejudice the interests of creditors;

(b) Transactions where a transfer of an interest in property or the undertaking of an obligation by the debtor was a gift or was made in exchange for a nominal or less than equivalent value or for inadequate value that occurred at a time when the debtor was insolvent or as a result of which the debtor became insolvent (undervalued transactions); and

(c) Transactions involving creditors where a creditor obtained, or received the benefit of, more than its pro rata share of the debtor's assets that occurred at a time when the debtor was insolvent (preferential transactions).

Avoidance of security interests

(88) The insolvency law should specify that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of insolvency law on the same grounds as other transactions.

Transactions exempt from avoidance actions

(92) The insolvency law should specify the transactions that are exempt from avoidance, including financial contracts.

Financial contracts

(103)Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

Participation by creditors

(126)The insolvency law should specify that creditors, both secured and unsecured, are entitled to participate in insolvency proceedings and identify what that participation may involve in terms of the functions that may be performed.

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[60] The use of the word "transaction" in this section is intended to refer generally to the wide range of legal acts by which assets may be disposed of or obligations incurred including by way of a transfer, a payment, granting of a security interest, a guarantee, a loan or a release or an action to make a security interest effective against third parties and may include a composite series of transactions.

Right to be heard and to request review

(137)The insolvency law should specify that a party in interest has a right to be heard on any issue in the insolvency proceedings that affects its rights, obligations or interests. For example, a party in interest should be entitled:

(a) To object to any act that requires court approval;

(b) To request review by the court of any act for which court approval was not required or not requested; and

(c) To request any relief available to it in insolvency proceedings.

Right of appeal[61]

(138)The insolvency law should specify that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests.

Voting mechanisms

(145)The insolvency law should establish a mechanism for voting on approval of the plan. The mechanism should address the creditors and equity holders who are entitled to vote on the plan; the manner in which the vote will be conducted, either at a meeting convened for that purpose or by mail or other means, including electronic means and the use of proxies; and whether or not creditors and equity holders should vote in classes according to their respective rights.

(146)The insolvency law should specify that a creditor or equity holder whose rights are modified or affected by the plan should not be bound to the terms of the plan unless that creditor or equity holder has been the given the opportunity to vote on approval of the plan.

(147)The insolvency law should specify that where the plan provides that the rights of a creditor or equity holder or class of creditors or equity holders are not modified or affected by a plan, that creditor or equity holder or class of creditors or equity holders is not entitled to vote on approval of the plan.

(148)The insolvency law should specify that creditors entitled to vote on approval of the plan should be separately classified according to their respective rights and that each class should vote separately.

(149)The insolvency law should specify that all creditors and equity holders in a class should be offered the same treatment.

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[61] In accordance with the key objectives, the insolvency law should provide that appeals in insolvency proceedings should not have suspensive effect unless otherwise determined by the court, in order to ensure that insolvency can be addressed and resolved in an orderly, quick and efficient manner without undue disruption. Time limits for appeal should be in accordance with generally applicable law, but in insolvency need to be shorter than otherwise to avoid interrupting insolvency proceedings.

Reorganization plan

Approval by classes

(150)Where voting on approval of the plan is conducted by reference to classes, the insolvency law should specify how the vote achieved in each class would be treated for the purposes of approval of the plan. Different approaches may be taken, including requiring approval by all classes or approval by a specified majority of the classes, but at least one class of creditors whose rights are modified or affected by the plan must approve the plan.

(151)Where the insolvency law does not require a plan to be approved by all classes, the insolvency law should address the treatment of those classes which do not vote to approve a plan that is otherwise approved by the requisite classes. That treatment should be consistent with the grounds set forth in recommendation 152.

Confirmation of an approved plan

(152)Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to confirm the plan if the following conditions are satisfied:

(a) The requisite approvals have been obtained and the approval process was properly conducted;

(b) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;

(c) The plan does not contain provisions contrary to law;

(d) Administrative claims and expenses will be paid in full, except to the extent that the holder of the claim or expense agrees to different treatment; and

(e) Except to the extent that affected classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

Challenges to approval (where there is no requirement for confirmation)

(153)Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit parties in interest, including the debtor, to challenge the approval of the plan. The insolvency law should specify criteria against which a challenge can be assessed, which should include:

(a) Whether the grounds set forth in recommendation 152 are satisfied; and

(b) Fraud, in which case the requirements of recommendation 154 should apply.

Secured claims

(172)The insolvency law should specify whether secured creditors are required to submit claims.

Unliquidated claims

(178)The insolvency law should permit unliquidated claims to be admitted provisionally, pending determination of the amount of the claim by the insolvency representative.

Valuation of secured claims

(180)The insolvency law should provide that the insolvency representative may determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset.

Secured claims

(188)The insolvency law should specify that secured claims should be satisfied from the encumbered asset in liquidation or pursuant to a reorganization plan, subject to claims that are superior in priority to the secured claim, if any. Claims superior in priority to secured claims should be minimized and clearly set forth in the insolvency law. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor.

B. Additional insolvency recommendations

Assets acquired after commencement of insolvency proceedings

232. Except as provided in recommendation 233, the insolvency law should provide that an asset of the estate acquired after the commencement of insolvency proceedings is not subject to a security right created by the debtor before the commencement of the insolvency proceedings.

233. The insolvency law should provide that an asset of the estate acquired after the commencement of insolvency proceedings with respect to the debtor is subject to a security right created by the debtor before the commencement of the insolvency proceedings to the extent the asset is proceeds (whether cash or non-cash) of an encumbered asset that was an asset of the debtor before commencement.

Automatic termination clauses in insolvency proceedings

234. If the insolvency law provides that a contract clause that, upon the commencement of insolvency proceedings or the occurrence of another insolvency-related event, automatically terminates any obligation under a contract or accelerates the maturity of any obligation under a contract, is unenforceable as against the insolvency representative or the debtor, the insolvency law should also provide that such provision does not render unenforceable or invalidate a contract clause relieving a creditor from an obligation to make a loan or otherwise extend credit or other financial accommodations to the benefit of the debtor.

Third-party effectiveness of a security right in insolvency proceedings

235. The insolvency law should provide that, if a security right is effective against third parties at the time of the commencement of insolvency proceedings, action

may be taken after the commencement of the insolvency proceedings to continue, preserve or maintain the effectiveness against third parties of the security right to the extent and in the manner permitted under the secured transactions law.

Priority of a security right in insolvency proceedings

236. The insolvency law should provide that, if a security right is entitled to priority under law other than insolvency law, the priority continues unimpaired in insolvency proceedings except if, pursuant to insolvency law, another claim is given priority. Such exceptions should be minimal and clearly set forth in the insolvency law. This recommendation is subject to recommendation 188 of the *UNCITRAL Insolvency Guide*.

Effect of a subordination agreement in insolvency proceedings

237. The insolvency law should provide that, if a holder of a security right in an asset of the insolvency estate subordinates its priority unilaterally or by agreement in favour of any existing or future competing claimant, such subordination is binding in insolvency proceedings with respect to the debtor to the same extent that such subordination is effective under non-insolvency law.

Costs and expenses of maintaining value of the encumbered asset in insolvency proceedings

238. The insolvency law should provide that the insolvency representative is entitled to recover on a first priority basis from the value of an encumbered asset reasonable costs and expenses incurred by the insolvency representative in maintaining, preserving or increasing the value of the encumbered asset for the benefit of the secured creditor.

Valuation of encumbered assets in reorganization proceedings

239. The insolvency law should provide that, in determining the liquidation value of encumbered assets in reorganization proceedings, consideration should be given to the use of those assets and the purpose of the valuation. The liquidation value of those assets may be based on their value as part of a going concern.