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Security Interests

Recommendations of the draft Legislative Guide on Secured Transactions

Report of the Secretary-General

Addendum

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* This document is submitted three weeks later than the required ten weeks prior to the start of the meeting because of the need to complete consultations and to finalize consequent amendments.

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VII. Pre-default rights and obligations of the parties

Purpose

The purpose of the provisions of the law on pre-default rights and obligations of the parties is to:

(a) Provide rules on additional terms for a security agreement with a view to rendering secured transactions more efficient and predictable;

(b) Reduce transaction costs by eliminating the need to negotiate and draft terms to be included in the security agreement where the rules provide an acceptable basis for agreement;

(c) Reduce potential disputes;

(d) Provide a drafting aid or checklist of issues the parties may wish to address at the time of negotiation and conclusion of the security agreement; and

(e) Encourage party autonomy.

Party autonomy

58.

Alternative A

The law should allow the parties to waive or vary their rights and obligations unless such waiver or variation is against public policy or fails to adequately protect third parties.

Alternative B

The law should provide that, except as otherwise provided in [specify the provisions that may not be derogated from or varied by agreement], the secured creditor and the grantor may derogate from or vary by agreement its provisions relating to their respective rights and obligations. Such an agreement should not affect the rights of any person who is not a party to the agreement.

[*Note to the Working Group: The Working Group may wish to consider the formulation of the recommendation on party autonomy and whether it should be placed in this chapter or in the chapter on scope and general provisions.*]

Suppletive rules

59. The law should include suppletive, non-mandatory rules that would apply in the absence of contrary agreement of the parties. Such rules should, inter alia:

(a) Provide for the care of the encumbered assets by either the grantor or the secured creditor in possession of the encumbered assets;

(b) Preserve the security rights in the encumbered assets, including the right to proceeds or civil fruits derived from the encumbered assets;

(c) Provide for the right of the grantor to continue the operation of its business including the right to use, commingle and dispose of the encumbered assets in the ordinary course of its business; and

(d) Secure the discharge of a security right once the obligation it secures has been paid or otherwise performed.

VIII. Default and enforcement

Purpose

The purpose of the provisions of the law on default and enforcement is to:

(a) Provide clear and simple procedures for the enforcement of security rights upon debtor default in a predictable and efficient manner;

(b) Maximize the realization value of the encumbered assets;

(c) Provide transactional finality upon compliance with the enforcement procedure;

(d) Define clearly the extent to which the secured creditor and the grantor may agree on the enforcement procedure;

(e) Provide that all parties, in enforcing their rights and performing their obligations under the secured transactions regime, must act in good faith, follow commercially reasonable standards and respect public policy; and

(f) Coordinate the enforcement rights and procedures of the secured transactions regime with the rights and procedures of other parties under other law, including insolvency law.

Judicial and extra-judicial enforcement

60. The law should provide options to the secured creditor following default to:

(a) Resort to court or other authorities to enforce its security right; or

(b) Enforce its security right without resorting to court or other authorities.

Release of the encumbered assets following full payment

61. Following default and until a disposition of the encumbered assets by the secured creditor, the debtor, the grantor or other interested parties should be entitled to pay in full the secured obligation, including interest and the costs of enforcement up to the time of full payment. The law should specify that the effect of such payment is to terminate the enforcement proceeding and to release the encumbered assets from the security right.

Notice of disposition of encumbered assets

62. The law should provide clear rules so as to ensure that any notice relating to the disposition of encumbered assets could be given in a simple, efficient, quick, inexpensive and reliable way so as to protect the debtor, the grantor or other

interested parties, while, at the same time, avoiding having a negative impact on the realization value of the encumbered assets.

Disposition of encumbered assets

63. The law should provide flexible procedures for the disposition of the encumbered assets that should be subject to an independent standard, such as the obligation to act in good faith and observe the standard of commercial reasonableness.

Collection of receivables

64. The law should provide flexible procedures for the collection of receivables, including the right to require any obligor thereon to make any payments owed directly to the secured creditor. These procedures should be subject to an independent standard, such as the obligation to act in good faith and observe the standard of commercial reasonableness.

[Notice of intention to pursue extra-judicial enforcement

65. The law should:

(a) Address whether a secured creditor should be required to give notice of its intention to pursue extra-judicial enforcement of a security right following default;

(b) State the minimum contents of the notice, the manner in which it is to be given, and its timing;

(c) State that the notice [to the grantor] should also contain the secured creditor's calculation of the amount owed as a consequence of default;

(d) Detail the steps the debtor or the grantor may take to obtain a release of the encumbered assets;

(e) Address the legal consequences of insufficient or erroneous notices of intention to pursue extra-judicial enforcement;

(f) List cases in which notice of intention to pursue extra-judicial enforcement would not be required in order to avoid a negative effect on the realization value of the encumbered assets;

(g) Provide whether the notice of intention to purse extra-judicial enforcement should be registered in the secured transactions registry; and

(h) Provide that the notice of intention to pursue extra-judicial enforcement should be in a language that is reasonably expected to inform its recipients about its contents, such as the language of the security agreement.]

Objections to extra-judicial enforcement

66. If the debtor, the grantor or other interested parties (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) object to actions of the secured creditor in enforcing its rights, the law should provide them with an opportunity to have judicial or administrative review of acts of the secured creditor. Safeguards should

be built into the process to discourage the debtor, the grantor or other interested third parties from making unfounded claims to delay the enforcement.

Party autonomy in extra-judicial proceedings

67. The law should permit parties to the security agreement to agree on the procedure for enforcement of security rights as between the parties, provided that the agreement conforms to the general rules of contract law and the obligation of the parties to act in good faith, follow commercially reasonable standards and not violate public policy. The person challenging the agreement on the procedure for enforcement has the burden of showing that the agreement does not meet the foregoing requirements.

Acceptance of the encumbered assets in satisfaction of the secured obligation and extra-judicial disposition of encumbered assets

68. The law should provide that a secured creditor who proposes to take the encumbered asset in total or partial satisfaction of the secured obligation, or who proposes to dispose of the encumbered asset without resorting to a court or other authority, must give advance notice of the proposal to:

(a) The grantor and any person who owes payment of the secured obligation (e.g. a guarantor);

(b) Any person with rights in the encumbered asset who has notified the secured creditor of those rights; and

(c) Any secured creditor who has registered notice of a security right in the encumbered asset in the name of the grantor or who was in possession of the encumbered asset at the time it was seized by the secured creditor.

69. The law should provide that, if a subordinate secured creditor or other person with subordinate rights in the encumbered assets objects in writing to a proposal to take the encumbered assets in satisfaction of the secured obligation, the secured creditor must dispose of the encumbered assets in accordance with the rules governing dispositions (see recommendations 63 and 64). However, the secured creditor should be entitled to apply to a court or other authority for a determination of the reasonableness of the objection.

Title acquired through non-judicial disposition

70. If the secured creditor elects to dispose of the encumbered asset without resorting to a court or other authority, the transferee acquires the encumbered assets subject to prior ranking rights but takes free of the rights of the grantor, the enforcing secured creditor, any subordinate secured creditors and any other subordinate claimant. The same rule applies to the title acquired by a secured creditor who has taken the encumbered assets in total or partial satisfaction of the secured obligation.

Title acquired through judicial disposition

71. If a secured creditor elects to dispose of the encumbered assets through a judicial or other officially administered State process, the title acquired by the buyer

and the distribution of the money realized by the disposition should be determined by the general rules of the State governing execution proceedings.

Right of the first-ranking secured creditor to take over enforcement

72. The first-ranking secured creditor is entitled to take control of enforcement initiated by a subordinate secured creditor at any time before final disposition of the encumbered assets to a transferee. The right to take control includes the right to choose whether or not the disposition process will be administered by a court or other authority.

Surplus and shortfall

73. The enforcing secured creditor must pay any surplus remaining after enforcement to subordinate secured creditors and any other subordinate claimants who gave prior notice of their claims to any surplus to the secured creditor. Any balance remaining must be remitted to the grantor. If there is any dispute as to the order of priority of payment, the secured creditor may pay the surplus into a separate deposit account for distribution by a court or other designated authority upon the application of a subordinate secured creditor or other subordinate claimant.

74. The grantor and any other person who owes payment of the secured obligation are liable for any deficiency still owing after enforcement.

Other remedies

75. The exercise of remedies under the law should not prevent any party from exercising their remedies under contract law.

Intersection of movable and immovable secured transactions law

76. The law should have special rules on:

(a) Whether a security right in fixtures is to be enforced in accordance with movable or immovable secured transactions law; and

(b) Whether, in the case of a security right in all assets of a grantor, including movables and immovables, enforcement of the security right in the movables is to take place in accordance with movable or immovable secured transactions law.

Coordination with other law

77. The law should be coordinated with general civil procedure law to provide a right for secured creditors to intervene in court proceedings initiated by other creditors of the grantor to protect security rights and to ensure the same priority status of security rights as under the law.

IX. Insolvency

78-99. [*Note to the Working Group: The recommendations on insolvency will be included after the completion of consultations.*]

X. Conflict of laws*

Purpose

The purpose of conflict of laws rules is to determine the law applicable to each of the following issues: the creation of a security right as between the parties; the effectiveness of a security right against third parties; the priority of a security right over the rights of competing claimants; and the enforcement of a security right.

These rules should also be applicable, to the extent appropriate, to rights that are not classified as "security rights" but which fulfil a similar economic function and are susceptible of competing with security rights, such as the rights of a buyer of receivables and a seller who retains title to goods in a retention-of-title arrangement.

[*Note to the Working Group: The reference to retention of title may not be necessary if the Working Group decides that they should be treated in the same way as security rights (see A/CN.9/WG.VI/WP.17 and Add.1).*]

Possessory security rights in tangible property

100. The law should provide that the creation as between the parties, the effectiveness against third parties and the priority over the rights of competing claimants of a possessory security right in tangible property are governed by the law of the State in which the encumbered asset is located.

[*Note to the Working Group: If the Working Group adopts Alternative B of recommendation 103, it may wish to consider whether recommendations 100 and 101 should include language along the following lines: "Subject to the rules applicable to proceeds under recommendation 103.*]

Non-possessory security right in tangible property

101. The law should provide that, subject to additional rules for goods in transit and export goods in recommendations 104 and 105 respectively, the creation as between the parties, the effectiveness against third parties and the priority over the rights of competing claimants of a non-possessory security right in tangible property (other than negotiable instruments and negotiable documents) are governed by the law of the State in which the encumbered asset is located. However, with respect to security rights in tangible assets of a type ordinarily used in more than one State, such issues are governed by the law of the State in which the grantor is located.

[*Note to the Working Group: The Working Group will recall that the structure and the formulation of recommendations 100 and 101 is the result of the discussion of previous drafts of these recommendations by the Working Group (see A/CN.9/WG.VI/WP.2/Add.11, A/CN.9/WG.VI/WP.9/Add.7 and A/CN.9/WG.VI/WP.13/Add.1). However, in view of that fact that the law applicable under recommendations 100 and 101 is the same (i.e. the lex rei sitae), the Working Group may wish to consider merging recommendations 100 and 101. In addition, the Working Group may wish to note that under the current formulation of recommendations 100 and 101 only recommendation 101 is subject to the special*

* Recommendations prepared in close cooperation with the Hague Conference on Private International Law.

rules on mobile goods (second sentence of recommendation 101), goods in transit (recommendation 104) and export goods (recommendation 105), since those recommendations relate to non-possessory security rights (possession being understood as actual, not fictive, possession). The Working Group may wish to consider the question whether both recommendations 100 and 101 should be subject to these special rules and, if so, whether that result could be better achieved, as a matter of drafting, by merging recommendations 100 and 101.]

Security right in intangible property

102. The law should provide that the creation as between the parties, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in intangible property are governed by the law of the State in which the grantor is located.

[*Note to the Working Group: The Working Group may wish to consider whether to apply the rule in this recommendation also to non-possessory security rights in negotiable instruments and negotiable documents.*]

Proceeds

103.

Alternative A

The law should provide that the conflict of laws rules applicable to the creation as between the parties, the effectiveness against third parties and the priority over the rights of competing claimants of proceeds of encumbered assets are the same as the rules applicable to a security right in original encumbered assets of the same kind as the proceeds.

Alternative B

The law should provide that:

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

(b) The conflict of laws rules applicable to the effectiveness against third parties and the priority over the rights of competing claimants of proceeds of encumbered assets are the same as the rules applicable to a security right in original encumbered assets of the same kind as the proceeds.

Goods in transit

104. The law should provide that a security right in tangible property (other than negotiable instruments or documents) in transit may also be created as between the parties and made effective against third parties under the law of the State of the ultimate destination, provided that the property reaches that State within a specified time period after the time of creation of the security right.

Export goods

105. The law should provide that a security right in tangible property (other than negotiable instruments or documents) to be exported may also be created and made effective against third parties under the law of the State of destination provided that the property thereafter [reaches the State of the ultimate destination] [leaves the enacting State] within a specified period of time after the time of creation of the security right.

[*Note to the Working Group: The definitions of the terms "location", "law", and "competing claimant" (based on definitions included in article 5 of the United Nations Convention on the Assignment of Receivables in International Trade) are included in recommendations because of their importance for the recommendations of this Chapter. To be consistent with the approach followed so far, the Working Group may wish to include these definitions in the commentary rather than in the recommendations. The Working Group may wish to consider that definitions that are relevant for more than one Chapter of the Guide may be included with the other definitions in the commentary of Chapter I. Definitions relevant for this Chapter only may be included in the commentary of this Chapter.*]

Meaning of "location"

106. The law should provide that the reference to the location of the grantor in recommendations 101 and 102 is the grantor's 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, the reference to the location of the grantor is to the grantor's habitual residence.

Relevant time when determining location

107. The law should provide that the reference to the location of the assets or of the grantor in recommendations 100 to 102 refers, for creation issues, to that location at the time of the creation of the security right and, for third-party effectiveness and priority issues, to that location at the time the issue arises.

[*Note to the Working Group: No reference is made to recommendations 104, 105 and 108, as they contain their own timing rules.*]

Continued third-party effectiveness upon change of location

108. The law should provide that, if a security right in encumbered assets is effective against third parties under the law of a State other than the enacting State and the location of the encumbered assets or the grantor (as applicable) changes to the enacting State, the security right continues to be effective against third parties under the law of the enacting State for a period of [to be specified] days after the location of the encumbered assets or the grantor (as applicable) has changed to the enacting State. If the requirements of the enacting State to make the security right effective against third parties are fulfilled prior to the end of that period, the security right continues to be effective against third parties thereafter in the enacting State.

Renvoi

109. The law should provide that the reference to "the law" of another State as the law governing an issue refers to the law in force in that State other than its conflict-of-laws rules.

Competing claimant

110. The law should provide that the reference to "competing claimant" in recommendations 100 to 103 and 113 to 115 means:

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

[(a*bis*) The seller or financial lessor of the same encumbered assets who has retained title to them pursuant to an [acquisition] [purchase-money] security right;]

(b) Another creditor of the grantor asserting a right in the same encumbered assets (e.g. by operation law, attachment or seizure or a similar process);

(c) The administrator in the insolvency of the grantor[; or

(d) A buyer of the encumbered assets].

Extent of party autonomy with respect to governing law

111. The law should provide that the mutual rights and obligations of the grantor and the secured creditor are governed by the law chosen by them by agreement, except that they may not derogate from the rules set forth in recommendations 100-110 and 113-116.

Law governing the mutual rights and obligations of the parties in the absence of agreement of the parties

112. The law should provide that, subject to the rules set forth in recommendations 100-110 and 113-116, in the absence of a choice of law by the grantor and the secured creditor, their mutual rights and obligations arising from the security agreement are governed by [the law of the State with which the security agreement is most closely connected] [the law governing the security agreement].

Enforcement matters

113. The law should provide that:

Alternative A

Substantive matters affecting the enforcement of a security right are governed by the law of the State where enforcement takes place.

Alternative B

Substantive matters affecting the enforcement of a security right are governed by the law governing the priority of the right over the rights of competing claimants, subject, however, to the rules of the State where enforcement takes place that are mandatory irrespective of the law otherwise applicable.

Alternative C

Substantive matters affecting the enforcement of a security right are governed by the law governing the contractual relationship of the secured creditor and the grantor, subject, however, to the rules of the State where enforcement takes place that are mandatory irrespective of the law otherwise applicable.

[*Note to the Working Group: Alternatives A, B and C refer to substantive matters (procedural matters are governed by the law of the State where enforcement takes place; see rec. 114). Although a Court would use its own law to determine what is substantive and what is procedural, the following are examples of issues generally considered to be substantive: the nature and extent of the remedies available to the creditor to realize the encumbered assets, whether such remedies (or some of them) may be exercised without judicial process, the conditions to be met for the secured creditor to be entitled to obtain possession and dispose of the assets (or to cause the assets to be judicially realized), the power of the secured creditor to collect receivables that are encumbered assets and the obligations of the secured creditor to the other creditors of the grantor.*]

Alternative D

Matters relating to the enforcement of a security right are governed by the law governing the mutual rights and obligations of the grantor and the secured creditor, except that a secured creditor may not take possession of tangible encumbered property from the grantor without the consent of the grantor [except in accordance with] [in violation of] the law of the State in which that property is then located. [Procedural matters in the course of a judicial proceeding relating to the enforcement of a security right are governed by the law of the forum.]

[*Note to the Working Group: Alternative D eliminates the reference to "substantive matters", utilizes the same formulation as recommendation 111 ("mutual rights and obligations") and focuses more directly on control over non-judicial repossession. The last sentence limits "procedural matters" to those arising in the course of a judicial proceeding and, if adopted, would eliminate the need for recommendation 114.*]

114. The law should provide that procedural matters relating to enforcement of security rights are governed by the law of the State where enforcement takes place.

[*Note to the Working Group: The Working Group may wish to consider merging this recommendation into recommendation 113.*]

Impact of insolvency on conflict-of-laws rules

115. The [secured transactions] law should provide that the commencement of insolvency proceedings in respect of the grantor does not displace the conflict-of-laws rules applicable to the creation and third-party effectiveness of a security right. With respect to priority of a security right over the rights of competing claimants, the law determined pursuant to the applicable conflict-of-laws rules should continue to govern, except as otherwise provided by the insolvency law.

[*Note to the Working Group: The Working Group may wish to consider whether the commentary should clarify the relationship of recommendation 115 and recommendation 30 of the UNCITRAL Insolvency Guide, which states the generally*

acceptable rule that the conflict-of-laws rules of the insolvency forum apply to the validity and effectiveness of rights and claims. The first sentence of recommendation 115 reflects that principle. The second sentence goes a step further and clarifies that the commencement of insolvency may change the law applicable, under the conflict-of-laws rules of the forum, to the priority of a security right over the rights of competing claimants, to the extent that insolvency law so provides (e.g. with respect to preferential claims).]

Enforcement in insolvency proceedings

116. The [secured transactions] law should provide that the insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) generally applies to all aspects of the enforcement of a security right in the insolvency proceedings (see also recommendation 31 of the UNCITRAL Insolvency Guide; with respect to exceptions to this principle, see recommendations 32-34 of the UNCITRAL Insolvency Guide).

XI. Transition

Purpose

The purpose of transition provisions of the law is to provide a fair and efficient transition from the regime before the enactment of the law to the regime after the enactment of the law.

Effective date

117. The law should specify a date or a mechanism by which a date may be specified, subsequent to its enactment, as of which it will enter into force (the "effective date") in view of:

(a) The impact of the effective date on credit decisions and in particular the maximization of benefits to be derived from the law;

(b) The necessary regulatory, institutional, educational and other arrangements or infrastructure improvements to be made by the State; the status of the pre-existing law and other infrastructure;

(c) The harmonization of the law with other legislation; and

(d) The content of constitutional rules with respect to pre-effective date transactions; and standard or convenient practice for the entry into force of legislation (e.g. on the first day of a month); and

(e) The need to give affected persons sufficient time to prepare for the law.

Transition period

118. The law should provide a period of time after the effective date (the "transition period"), during which creditors with security rights effective against the grantor and third parties under the previous regime may take steps to assure that those rights are effective against the grantor and third parties under the law. If those steps are

taken during the transition period, the law should provide that the effectiveness of the creditor's rights against those parties is continuous.

Priority

119. The law should provide clear rules for resolving:

(a) Which law applies to the priority between post-effective date security rights;

(b) Which law applies to the priority between pre-effective date security rights; and

(c) Which law applies to the priority between pre-effective date and post-effective date security rights.

120. The law should provide that priority between post-effective date security rights is governed by the law.

121. The law should provide generally that priority between pre-effective date security rights is governed by the former legal regime. The law should also provide, however, that application of those former rules will occur only if no event occurs after the effective date that would have changed the priority under the former regime. If such an event occurs, the law should determine priority.

122. With respect to priority between pre-effective date security rights and post-effective date security rights, the law should provide that it will apply as long as the holder of a pre-effective date right may, during the transition period, ensure priority under the law by taking whatever steps are necessary under the law. During the transition period, the priority of the pre-effective date right should continue as though the law had not become effective. If the appropriate steps are taken during the transition period, the holder of the pre-effective date right should have priority to the same extent as would have been the case had the law been effective at the time of the original transaction and those steps had been taken at that time.

123. When a dispute is in litigation (or a comparable dispute resolution system) or the secured creditor has taken steps towards enforcing its rights at the effective date of the law, the law should specify that it does not apply to the rights and obligations of the parties.

124. The law should deal with the transition from a regime in which no filing required to a regime where filing is a condition for ensuring the effectiveness of security rights as against third parties.

125. The law should ensure that the transition should not entail any cost other than the nominal cost of registration.