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Draft legislative guide on secured transactions: terminology and recommendations

Note by the Secretariat

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Terminology and rules of interpretation[1]

1. The present 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 particular term appears to be the same as that found in a particular national law, the meaning given to the term may differ. This approach is taken to provide readers with a common vocabulary and conceptual framework and to encourage harmonization of the law governing security rights.

2. "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 forum State and foreign creditors, unless otherwise specified.] References to "person" should be interpreted as including both natural and legal persons, unless otherwise specified. The term "law" throughout the Guide is intended to include both statutory and non-statutory law. The phrase "law governing negotiable instruments" or any similar expression encompasses all law that applies to negotiable instruments, including not only negotiable instrument law but also contract and other law that might be applicable. The same rule applies to the phrase "law governing negotiable documents".

3. The following paragraphs identify the principal terms used and the core meaning given to them in the Guide. The meaning of those terms is further refined when they are used in subsequent chapters, which also define and use additional terms (as is the case, for example, with the chapter on insolvency). The definitions should be read together with the relevant recommendations.

(a) "Security right" means a consensual property right in movable property and attachments that secure payment or other performance of one or more obligations, regardless of whether the parties have designated it as a security right. It includes acquisition security rights and non-acquisition security rights. With respect to receivables, security right also means an outright transfer of a receivable, as well as a transfer by way of security. References to a "security right" in the Guide also refer to the "right of an assignee";

(b) "Acquisition security right" means [, in the context of a unitary approach,] a security right in an asset that secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred to enable the grantor to acquire the asset. Acquisition security rights include rights, which are denominated as security rights, as well as rights acquired under retention-of-title sales, hire-purchase transactions, financial leases and purchase-money lending transactions. "Grantor" of an acquisition security right includes a buyer, financial lessee or grantor in a purchase-money lending transaction. "Acquisition financier" means the secured creditor with an acquisition security right and includes a retention-of-title seller, financial lessor or purchase-money lender;

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[1] The definitions and the rules of interpretation are part of the commentary, not of the recommendations of the Guide. They are included in the present document for the Working Group's ease of reference. They are based on the definitions and rules of interpretation contained in document A/CN.9/WG.VI/WP.27/Add.1, unless otherwise indicated.

[*Note to the Working Group: The Working Group may wish to define "acquisition financing devices" along the following lines:*

"Acquisition financing devices [in the context of a unitary approach] are arrangements that, whether denominated as security devices or not, enable a person to acquire possession or use of assets subject to an obligation to pay their price to a person that retains a security right in them until the price is paid."

This definition could be placed right before the definition of "acquisition security right".

The Working Group may also wish to consider that additional definitions are necessary for the non-unitary approach along the following lines:

(a) "Retention of title devices" [in the context of a non-unitary approach] are arrangements that enable a person to acquire possession or use of assets subject to an obligation to pay their price to a person who retains title in them until the price is paid. Retention-of-title devices [in the context of a non-unitary approach] include retention-of-title sales, hire-purchase agreements, financial leases and purchase-money lending transactions; and

(b) "Ownership right under a retention of-title device" [in the context of a non-unitary approach] is ownership in an asset that secures the obligation to pay any unpaid portion of the purchase price of the asset or other obligation incurred to enable the buyer, financial lessee or grantor to acquire the asset." (For this note, see A/CN.9/WG.VI/WP.24/Add.5, note to the definitions).]

(c) "Secured obligation" means the obligation secured by a security right;

(d) "Secured creditor" means a creditor that has a security right. References to the "secured creditor" in the Guide also refer to the "assignee";

(e) "Debtor" means a person that owes performance of the secured obligation [and includes secondary obligors, such as guarantors of a secured obligation]. The debtor may or may not be the person that grants the security right to a secured creditor (see grantor);

(f) "Grantor" means a person that creates a security right in one or more of its assets in favour of a secured creditor to secure either its own obligation or that of another person (see debtor of the receivable). References to the "grantor" in the Guide also refer to the "assignor";

[*Note to the Working Group: The Working Group may wish to note that the third sentence in the definitions of "security right", and the second sentence in the definitions of "secured creditor" and "grantor" is intended to ensure that the general recommendations apply to security rights in receivables and to outright transfers of receivables, unless otherwise provided*.]

(g) "Security agreement" means an agreement between a grantor and a creditor, in whatever form or terminology, that creates a security right;

(h) "Encumbered asset" means tangible or intangible movable property that is subject to a security right;

(i) "Tangible property" means all forms of corporeal movable property. Among the categories of tangibles are inventory, equipment, attachments, negotiable instruments and negotiable documents;

(j) "Inventory" means a stock of tangibles held for sale or lease in the ordinary course of business and also raw and semi-processed materials (work-in-process);

(k) "Equipment" means tangibles used by a person in the operation of its business;

(l) "Attachments to immovable property" means tangibles that are so physically attached to immovable property as to be treated as immovable property without however losing their identity as movables under the law of the State where the immovable property is located;

[*Note to the Working Group: The Working Group may wish to note that the commentary will set forth examples of attachments to immovable property, such as air-conditioning equipment or furnace but not bricks or cement (for this note, see A/CN.9/WG.VI/WP.26/Add.4, definitions)*.]

(m) "Attachments to movable property" means tangibles that are so physically attached to other movable property [as to be treated as part of that movable property], without however losing their identity under law other than this law;

[*Note to the Working Group: The Working Group may wish to note that the commentary will set forth examples of attachments to movable property, such as tires and aircraft engines (for this note, see A/CN.9/WG.VI/WP.26/Add.4, definitions)*.]

(n) "Mass or product" means tangibles other than money that are so physically associated or united with each other that they lose their separate identity under law other than this law;

(o) "Intangible property" means all forms of movable property other than tangibles. Among the categories of intangibles are receivables and other rights to the performance of non-monetary obligations;

(p) "Receivable" means a right to payment of a monetary obligation and a contractual right to performance of a non-monetary obligation excluding rights to payment evidenced by a negotiable instrument, the obligation to pay under an independent undertaking and the obligation of a bank to pay funds credited to a bank account;

[*Note to the Working Group: The Working Group may wish to note that the definition of "receivable" has been revised to reflect the understanding of the Working Group that the general recommendations, as supplemented by the recommendations on receivables, should apply to: (a) contractual non-monetary receivables (see A/CN.9/603, para. 35); and (b) non-contractual receivables (see A/CN.9/603, para. 36). In addition, language has been added in definition (w), "original contract", to ensure that reference to "original contract" includes any other non-contractual source of a receivable. Moreover, language has been added within square brackets to: (a) recommendation 22 (effectiveness of a bulk assignment and an assignment of future, parts of and undivided interests in*

receivables) to ensure that statutory limitations on the assignability of non-contractual receivables is not interfered with; and (b) to recommendation 109 (representations of the assignor) to ensure that the recommendations dealing with representations of the assignor do not apply to an assignment of a non-contractual receivable (see A/CN.9/603, para. 36; see also notes to recommendations 2, subparagraph (a), 22 and 109).]

(q) "Assignment" means the creation of a security right in a receivable, including an outright transfer of a receivable;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the creation of a security right in a receivable includes an outright transfer of receivables by way of security, which is treated in the Guide as a security right*.]

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

(s) "Assignee" means the person to which an assignment of a receivable is made;

(t) "Subsequent assignment" means an assignment by the initial or any other assignee. 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;

(u) "Debtor of the receivable" means a person liable for payment of a receivable. "Debtor of the receivable" includes a guarantor, as an accessory guarantee is a receivable;

[*Note to the Working Group: The Working Group may wish to recall that, at its tenth session, it agreed that the word "account" should be deleted from the references to "the account debtor". The term "account debtor" has been replaced with the term "debtor of the receivable". Thus, the word "debtor" continues to refer to the debtor of the secured obligation and confusion with that term is avoided. In addition, this approach is consistent with the United Nations Assignment Convention, in which reference is made to "the debtor" to denote "the debtor of the receivable". The slight difference in the terminology is due to the fact that the Convention uses the term "assignor" to refer to the debtor of the secured obligation*.]

(v) "Notice" means a communication in writing [, except where otherwise provided in the Guide]. "Notification of the assignment" means a communication in writing that reasonably identifies the assigned receivable and the assignee. The writing requirement is met by an electronic communication if the information contained therein is accessible so as to be usable for subsequent reference (see article 6 of the UNCITRAL Model Law on Electronic Commerce and article 9 (2) of the Electronic Contracting Convention);

[*Note to the Working Group: The Working Group may wish to note that the Guide refers to several types of notice (i.e. notice registered in the general security rights registry, notice of default, notice of intention to pursue extrajudicial enforcement, notification of the assignment and notification of inventory financiers on record). The Working Group may wish to consider whether any of these notices should not be in writing and whether the same term should be used for all notices or*

a different term should be used for some of them (e.g. "notice" or "registered notice" for the notice registered in the general security rights registry and "notification" for all other notices).

The Working Group may wish to note that the rule that "writing" includes electronic communications is reflected in recommendation 10. Depending on whether the reference to a "signed writing" is retained in recommendations 13 (creation) and 116, subparagraph (c) (agreement not to raise defences of the debtor of the receivable), the Working Group may wish to consider whether the rule contained in recommendation 11 that "signature" includes electronic signature should be reflected in the definitions as well as in recommendation 11.]

(w) "Original contract" in the context of an assignment means the contract between the assignor and the debtor of the receivable from which the receivable arises. With respect to the non-contractual receivables, "original contract" means the non-contractual source of the receivable;

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

(y) "Negotiable document" means a document that embodies a right for delivery of tangibles, such as a warehouse receipt or a bill of lading, and satisfies the requirements for negotiability under the law governing negotiable documents;

(z) "Independent undertaking" means a letter of credit (commercial or standby), a confirmation of a letter of credit, an independent guarantee (demand, first demand, bank guarantee or counter-guarantee) or any other undertaking recognized as independent by law or practice rules, such as the United Nations Convention on Independent Guarantees and Standby Letters of Credit ("the United Nations Guarantee and Standby Convention"), the Uniform Customs and Practice for Documentary Credits, the International Standby Practices, and the Uniform Rules for Demand Guarantees;

(aa) "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 delivered by the guarantor/issuer honouring or by a nominated person giving value for a draw under an independent undertaking. The term does not include:

(i) The right to draw (i.e. to request payment) under an independent undertaking; or

(ii) What is received under an independent undertaking or upon disposition of proceeds under an independent undertaking (i.e. the proceeds themselves);

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the definition refers to "proceeds under an independent undertaking" to be consistent with terminology generally used in independent undertaking law and practice. The term as used in the Guide means the right of the grantor as beneficiary of an independent undertaking to receive whatever payment or other value is given under the independent undertaking contingent upon the beneficiary's compliance with the terms and conditions of the independent undertaking. The term does not include the proceeds themselves, that*

is, what is actually received upon honour of a drawing from the guarantor/issuer, confirmer or nominated person (a beneficiary's receipt of value from a negotiating bank should not be characterized as honour or disposition) or upon disposition of a right to proceeds under an independent undertaking.

The term "proceeds under an independent undertaking" refers to a right to receive even though the term "proceeds" as used in independent undertaking law and practice may refer either to the right to receive or to whatever is received under the independent undertaking and even though the term "proceeds" as used elsewhere in the Guide refers to whatever is received. The commentary will highlight the distinction between a security right in proceeds under an independent undertaking (as an original encumbered asset) and the "proceeds" (a key concept of the Guide) of assets covered in the Guide.]

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

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in line with article 6, subparagraph (e), of the United Nations Guarantee and Standby 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*.]

(dd) "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;

(ee) A secured creditor has "control" [as against a guarantor/issuer, confirmer or nominated person] with respect to proceeds under an independent undertaking:

(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.

[*Note to the Working Group: The Working Group may wish to refer with respect to the bracketed text to the note to recommendation 96 (priority of a security right in proceeds under an independent undertaking)*.]

(ff) "Acknowledgment" with respect to proceeds under an independent undertaking means that the guarantor/issuer, confirmer or nominated person that will pay or otherwise give value upon a 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 proceeds from an independent undertaking; or

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

(gg) "Bank account" means an account that is maintained by a bank into which funds may be deposited or 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 claim against the bank arising under law governing negotiable instruments;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the right to payment of funds credited to a bank account covers a right to the payment of funds transferred into an internal account of the bank and not applied to any obligations owing to the bank. The commentary will also explain that funds transferred to the bank by way of anticipated reimbursement of a future payment obligation that the bank has accepted in the ordinary course of its banking business is also covered to the extent that the person that gave the bank instructions has a claim to those funds if the bank does not make the future payment*.]

(hh) A secured creditor has "control" with respect to a right to payment of funds credited to a bank account:

(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, according to which the depositary bank has agreed to follow instructions from the secured creditor with respect to the right to payment of funds credited to the bank account without further consent of the grantor; or

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that: (a) there is no obligation on a depositary bank to enter into a control agreement; (b) that a secured creditor's rights will be subject to the rights and obligations of the depositary bank under law and practice governing bank accounts; and (c) a control agreement requires the consent of the grantor (as well as of the depositary bank) and the grantor retains the right to deal with the funds in the bank account until the secured creditor instructs the depositary bank otherwise (although in some control agreements the funds would be blocked from the time of the conclusion of the control agreement). The commentary will also explain that subparagraph (c) covers situations where: (a) an existing account is transferred to the secured creditor; (b) the secured creditor agrees with the grantor that funds should be deposited to an account to be opened later; and (c) the secured creditor is the only account holder (i.e. not merely a joint account holder)*.]

(ii) "Intellectual property right" includes patents, trademarks, service marks, trade secrets, copyright and related rights and designs. It also includes rights under licences of such rights;

(jj) "Proceeds" means whatever is received in respect of encumbered assets. For example, proceeds include what is received as a result of sale or other disposition, collection, lease or licence of an encumbered asset, proceeds of

proceeds, civil and natural fruits, dividends, distributions, insurance proceeds and claims arising from defects, damage or loss;

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

(ll) "Competing claimant" means:

(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 system for acquisition security rights, the seller, financial lessor or purchase-money lender of the same encumbered asset that has retained title to it;

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

(iv) The insolvency representative in the insolvency of the grantor;[2] or

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

(mm) "Possessory security right" means a security right in tangibles that are in the actual possession of the secured creditor or of another person (other than the debtor or other grantor) holding the asset for the secured creditor;

(nn) "Non-possessory security right" means a security right in: (i) tangibles that are not in the actual possession of the secured creditor or another person holding the tangibles for the benefit of the secured creditor, or (ii) intangibles;

[*Note to the Working Group: The Working Group may wish to consider whether subparagraphs (mm) and (nn) are necessary after the decision not to make such a distinction between possessory and non-possessory security rights. The terms are used only in recommendations 1, subparagraph (e) (key objectives), and 2, subparagraph (d) (assets, parties, secured obligations and security rights)*.]

(oo) "Possession", except as the term is used in recommendations 27 and 48-50 with respect to the issuer of a negotiable document, means the actual possession of tangibles by a person or an agent or employee of that person, or by another person holding on behalf of that person, or an independent person that acknowledges that it holds for that person. It does not include constructive, fictive or symbolic possession;

(pp) "Issuer" of a negotiable document means the person that is obligated to deliver the tangibles covered by the document under the law governing negotiable documents;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in the case of a so-called multimodal bill of lading (if it qualifies as a negotiable document under the applicable law), the "issuer" may be a person that subcontracts various portions of the transport of the goods to other*

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[2] 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* (see footnote 55).

persons but still takes responsibility for their transport and for any damage that might occur during carriage.]

(qq) "Insolvency court" means a judicial or other authority competent to control or supervise an insolvency proceeding;

(rr) "Insolvency estate" means assets and rights of the debtor that are controlled or supervised by the insolvency representative and subject to the insolvency proceedings;

(ss) "Insolvency proceedings" means collective judicial or administrative proceedings for the purposes of either reorganization or liquidation of the debtor's business conducted according to the insolvency law;

(tt) "Insolvency representative" means a person or body responsible for administering the insolvency estate;

(uu) "Buyer in the ordinary course of business" means a person that buys inventory in the ordinary course from a person in the business of selling tangibles of that kind and without knowledge that the sale violates the rights of the secured creditor under the security agreement [or other rights of another person in the tangibles];

(vv) "Lessee in the ordinary course of business" means a person that leases inventory in the ordinary course from a person in the business of leasing tangibles of that kind and without knowledge that the lease violates the rights of the secured creditor under the security agreement [or other rights of another person in the tangibles];

(ww) "Licensee in the ordinary course of business" means a person that licenses intangible property in the ordinary course from a person in the business of licensing property of that kind and without knowledge that the license violates the rights of the secured creditor under the security agreement [or other rights of another person in the property];

[*Note to the Working Group: The Working Group may wish to note that the terms "buyer in the ordinary course of business", "lessee in the ordinary course of business" and "licensee in the ordinary course of business" are referred to in recommendation 83 (rights of buyers, lessees and licensees of encumbered assets). The commentary will clarify that it is possible for a buyer, lessee or licensee to know of the existence of a security right but not know whether the transfer violates the terms of the security agreement. The commentary will also explain that, in the rare cases in which the buyer of inventory has knowledge not only of the security right but also that the sale violates the terms of the security agreement, the buyer will not qualify as a buyer in the ordinary course of business and, therefore, not take free under recommendation 83, subparagraph (a). The commentary will also clarify that the test in recommendations 83 is the same as in recommendations 94 priority of a security right in a right to payment of funds credited to a bank account) and 95 (priority of a security right in money)*.]

(xx) "Consumer goods" means goods intended to be used for personal, family or household purposes.

Recommendations[3]

I. Key objectives of an effective and efficient secured transactions law[4]

Purpose

The purpose of the recommendation on key objectives is to provide a broad policy framework for the establishment and development of an effective and efficient secured transactions law. This recommendation could be included in a preamble to the secured transactions law as a guide to the underlying legislative policies to be taken into account in the interpretation and the application of the secured transactions law (hereinafter referred to as "the law").

Key objectives

1. 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 credit 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 non-possessory security rights;

(f) To encourage responsible behaviour on the part of all parties by enhancing predictability and transparency;

(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;

(j) To recognize party autonomy; and

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

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[3] The recommendations in the present document are based on recommendations contained in the document indicated in a footnote next to the title of each chapter, unless otherwise indicated in a footnote next to the title of a particular recommendation or note.

[4] See A/CN.9/WG.VI/WP.26/Add.7.

II. Scope of application[5]

Purpose

The purpose of the scope provisions of the law is to establish a single comprehensive regime for secured transactions. It should specify the assets, the parties, the secured obligations and the security rights to which the law applies.

Assets, parties, secured obligations and security rights

2. The law should apply:

(a) To all types of movable property and attachment, tangible or intangible, present or future, including inventory, equipment and other goods, contractual and non-contractual receivables, contractual non-monetary obligations, negotiable instruments, negotiable documents, rights to payment of funds credited to a bank account, proceeds under an independent undertaking and intellectual property rights;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general recommendations, as supplemented by the recommendations on receivables apply to: (a) contractual and non-contractual receivables (however, recommendations 22 and 109 do not apply to non-contractual receivables); and (b) contractual non-monetary obligations. The commentary will also explain that law other than the law recommended in the Guide applies to the rights of obligors of contractual non-monetary obligations (see also notes to definition (p), "receivable" and recommendations 22 and 109)*.]

(b) To all legal and natural persons, including consumers, without, however, affecting their rights under consumer-protection legislation;

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

(d) To all types of possessory and non-possessory security right in movable property;

(e) To all types of property right created contractually to secure the payment or other performance of an obligation, irrespective of the form of the relevant transaction, including the various forms of retention of title, financial leases and hire-purchase agreements, as well as transfers of title by way of security.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that, while the Guide applies to security rights (defined as consensual security rights), the chapter on priority applies to priority contests between consensual and non-consensual security rights*.]

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[5] See A/CN.9/WG.VI/WP.26/Add.7.

Outright transfers of receivables[6]

3. The law should apply to outright transfers of receivables, subject to recommendation 160 (application of the chapter on enforcement to outright transfers of receivables).

[*Note to the Working Group: The Working Group may wish to note that, as definition (p), "receivable", excludes rights to payment under a negotiable instrument, the obligation to pay under an independent undertaking and the obligation of a bank to pay funds credited to a bank account, recommendation 3 does not apply to an outright transfer of a negotiable instrument, proceeds under an independent undertaking or a right to payment of funds credited to a bank account. However, the recommendations of the Guide apply to transfers of such assets for security purposes, as they are treated as secured transactions.*

The commentary will explain that outright transfers of negotiable instruments, proceeds under an independent undertaking and funds credited to a bank account have been excluded as: (a) they raise different issues and would require special rules; and (b) unlike receivables in which a security transfer and an outright transfer would compete for priority based on the order of registration, with respect to negotiable instruments a secured creditor could always obtain a superior right by taking possession of the instrument. Similarly, with respect to proceeds under an independent undertaking and rights to payment of funds credited to a bank account, a secured creditor could always obtain a superior right by control. The commentary will also discuss issues arising in outright transfers of negotiable instruments other than cheques for the benefit of States that may wish to address them in the law (for this note, see A/CN.9/611, note to recommendation 3, subparagraph (f)).

In that connection, the Working Group may wish to note that the commentary will explain that, while principles of secured transactions law can easily be made to apply to the outright transfer of promissory notes and, perhaps, bills of exchange other than cheques, in a manner similar to the Guide's coverage of the outright transfer of receivables, those principles do not apply well to the outright transfer of cheques. The latter topic is sufficiently covered by the law of negotiable instruments and the law of bank collections.

The commentary will also explain that an enacting State that wishes to expand the scope of its secured transactions law to apply to outright transfers of negotiable instruments that are either promissory notes or bills of exchange (and to expand its definition of "security right" to cover the right of the transferee in such a transaction) might wish to consider providing that a security right that is an outright transfer of such a negotiable instrument is automatically effective against third parties upon the transfer. Such a rule would avoid disrupting existing financial practices.

In addition, the commentary will explain that, with respect to the priority of such a security right, the general principles of priority would apply. Most particularly, the general principle in recommendation 76, as qualified by recommendations 89 and 90, would govern. As in the case of an outright transfer of a receivable, the outright transferee of such a negotiable instrument should be able to enforce the instrument without further consent of the assignor subject to the

[6] See A/CN.9/611, recommendation 3, subparagraph (f).

rights of the obligors on the negotiable instrument as described in the chapter on enforcement (for the preceding 3 paragraphs, see A/CN.9/611/Add.1, note to recommendation 3, subparagraph (f)).]

Aircraft, railway rolling stock, space objects, ships and intellectual property

4. Notwithstanding recommendation 2, subparagraph (a), the law should not apply:

(a) To aircraft, railway rolling stock, space objects, ships and attachments thereto to the extent that the recommendations of this law are inconsistent with existing special laws or international obligations of the State relating to these types of asset. Where a direct inconsistency exists, the law should expressly confirm that the special laws and international obligations govern those assets to the extent of that inconsistency;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the reference to "aircraft, railway rolling stock, space objects and ships" should be understood pursuant to the meaning of those terms in national law or international conventions dealing with them*.]

(b) To intellectual property rights to the extent that the recommendations of this law are inconsistent with existing laws or international obligations of the State relating to these assets.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a State enacting secured transactions legislation in accordance with the Guide should consider whether it might be appropriate to adjust certain of the recommendations as they apply to security rights in intellectual property. In this regard, a State should examine its existing intellectual property laws and the State's obligations under intellectual property treaties, conventions and other international agreements and, in the event that the recommendations of the Guide are directly inconsistent with any such existing laws or obligations, the State's secured transactions law should expressly confirm that those existing intellectual property laws and obligations govern such issues to the extent of the inconsistency.*

In considering whether any adjustments of the recommendations as they apply to security rights in intellectual property are appropriate, a State should analyse each circumstance on an issue-by-issue basis and should have proper regard both to establishing an efficient secured transactions regime and to ensuring the protection and exercise of intellectual property rights in accordance with international conventions and national laws.

The Working Group may wish to note that, at its thirty-ninth session, the Commission requested the Secretariat to prepare a paper on intellectual property financing for consideration at its fortieth session with a view to providing further guidance to States with respect to intellectual property financing.]

Securities and immovable property

5. The law should provide that it does not apply to [indirectly held] securities and immovable property, although it may affect such assets, as provided in recommendations 24 and 45.

[*Note to the Working Group: The Working Group may wish to note that securities and immovable property are excluded from the scope of the Guide as original encumbered assets. However, they may be affected by the recommendations of the Guide.*

If a security right in securities or a mortgage secures a receivable, negotiable instrument or other obligation and the receivable, negotiable instrument or other obligation is assigned, the security right in the securities or the mortgage follows. This rule does not affect any third-party rights, priority and enforcement requirements existing under securities or immovable property law. For example, a security right in intermediated securities that was made effective against third parties by a book entry or control under securities law will have priority.

The Working Group may wish to consider whether, if securities or immovable property are proceeds of an asset covered in the Guide, the security right extends to such proceeds. If so, language may need to be added to ensure that third-party rights, priority and enforcement of the security right in securities or immovable property as proceeds are subject to securities or immovable property law as applicable.

In addition, the Working Group may wish to note that the bracketed text in recommendation 5 is intended to avoid excluding from the scope of the Guide directly held securities to the extent they are not subject to any special legislation (even the UNIDROIT draft Convention on Substantive Rules Regarding Intermediated Securities does not apply to directly held securities). Thus, no gap would be left with respect to, for example, security rights in shares of a subsidiary all held by the parent company, since such security rights are involved in significant commercial loan transactions.]

Employment payments

6. The law should provide that it does not apply to receivables in the form of remunerations, retirement payments, employment benefits and other payments accruing from employment contracts or relations, as well as other similar payments (e.g. family support payments) to the extent that law other than this law restricts the grant of security rights in or the transfer of such receivables.

Other exceptions

7. The law should limit any other exceptions to its scope of application and, to the extent any other exceptions are made, they should be set forth in the law in a clear and specific way.

III. Basic approaches to security and other general rules[7]

Purpose

The purpose of the recommendations on basic approaches to security is to ensure that the law covers in an integrated and consistent manner all forms of rights in movable property that serve security purposes.

[7] See A/CN.9/WG.VI/WP.26/Add.7.

Integrated and functional approach

8. The law should establish an integrated and consistent set of provisions on security rights in tangibles and intangibles. Its rules should apply to all contractually created rights (regardless of form) in movable property that secure an obligation, including rights under a transfer of title to tangibles or an assignment of receivables for security purposes, a retention of title sale, a financial lease or a hire-purchase agreement [, except to the extent otherwise provided in recommendations 171 (non-unitary approach to acquisition financing devices, alternative B) and 193 (enforcement of ownership rights under retention-of-title devices, non-unitary approach, alternative B)].

Party autonomy

9. The law should provide that, except as otherwise provided in [specify the provisions that may not be derogated from or varied by agreement, e.g. standard of conduct in the context of enforcement], 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.

Electronic communications

10. 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.

[*Note to the Working Group: The Working Group may wish to note that this recommendation tracks the language of article 9 (2) of the United Nations Electronic Contracting Convention, which is consistent with article 6 of the UNCITRAL Model Law on Electronic Commerce*.]

11. [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

(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].

[*Note to the Working Group: The Working Group may wish to note that this recommendation tracks the language of article 9 (3) of the United Nations Electronic Contracting Convention, which is consistent with article 7 of the UNCITRAL Model Law on Electronic Commerce. The Working Group may also wish to note that according to recommendation 116, subparagraph (c) (agreement not to*

raise defences or rights of set-off), a signed writing is required for a waiver of the defences of the debtor of a receivable.]

IV. Creation of a security right (effectiveness as between the parties)[8]

Purpose

The purpose of the provisions of the law dealing with creation is to specify the way in which a security right in movable property is created (i.e. becomes effective as between the parties).

A. General recommendations

Creation of a security right

12. The law should provide that a security right is created by agreement between the grantor and the secured creditor that identifies the secured creditor and the grantor and reasonably describes the secured obligation and the assets to be encumbered. A generic description of the encumbered assets is sufficient (e.g. "all assets" or "all inventory").

13. The law should provide that the agreement may be oral if accompanied by transfer of possession of the encumbered asset. Otherwise, the agreement must be in a writing [signed by the grantor in accordance with recommendation 11] [that evidences the intent of the grantor to grant a security right].

Time of creation

14. The law should provide that a security right is created when the requirements for the security agreement under recommendations 12 and 13 (creation of a security right) are fulfilled and the grantor has rights in the assets or the right to encumber the assets, unless the parties agree to a later date.

Obligations subject to a security agreement[9]

15. The law should provide that a security right may secure any type of obligation, present or future, determined or determinable, as well as conditional and fluctuating obligations.

Assets subject to a security agreement

16. The law should provide that a security right may be given in any type of asset, including parts of assets and undivided interests in assets. A security agreement may cover 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. Any exceptions to these rules should be limited and described in the law in a clear and specific way.

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[8] See A/CN.9/WG.VI/WP.26/Add.7.

[9] See A/CN.9/611.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a security right in future assets or assets belonging to third parties is not created until the grantor acquires a right in those assets. Other law (e.g. sales or property law) may permit a person to grant a security right or otherwise dispose of assets that it does not own (e.g. a rule that protects a good faith transferee that acquires a right from a grantor in possession of assets it does not own)*.]

17. The law should provide that a security right may be granted in all assets of a grantor.

[*Note to the Working Group: The Working Group may wish to note that the commentary discusses an approach taken in some legal systems of preserving in the case of insolvency of a person that has granted a security right in all its assets (for a discussion of all-asset security, see A/CN.9/WG.VI/WP.11/Add.2, paras. 20-25) a certain percentage of the value of the encumbered assets for unsecured creditors (see A/CN.9/WG.VI/WP.9/Add.6, paras. 33-35). However, for the reasons set forth in the commentary, the Guide does not recommend this approach (see recommendation 85 (priority of preferential claims))*.]

Creation of a security right in proceeds[10]

18. The law should provide that, unless otherwise agreed by the parties to the security agreement, the security right in the encumbered asset extends to its identifiable proceeds.

19. [The law should provide that, notwithstanding recommendation 18, the security right extends to proceeds in the form of civil and natural fruits of encumbered assets, only if the parties so provide in the security agreement.]

[*Note to the Working Group: The Working Group may wish to note that recommendation 19 introduces a different approach to civil and natural fruits of encumbered assets from the approach taken in recommendation 18 with respect to other types of proceeds. However, the notion of "proceeds", as defined in the terminology section, includes civil and natural fruits, and the natural expectation may be that the security right will extend automatically to civil and natural fruits. Thus, the Working Group may wish to consider deleting recommendation 19.*

In addition, the Working Group may wish to consider all the definitions and recommendations on security rights in proceeds together (i.e. definition (jj) and recommendations 18-21, 43-44, 80, 173-174, 191-192 and 198). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

Commingled proceeds

20. The law should provide that, where proceeds in the form of money have been commingled with other property so that the proceeds are not identifiable, the amount of the proceeds immediately before they were commingled with other property is to be treated as identifiable proceeds, provided that, at any time after commingling, the total amount of the property was more than the amount of the

[10] See A/CN.9/WG.VI/WP.26/Add.4, recommendations 29, 29 bis and 30.

proceeds. If, at any time after commingling, the total amount of the property was less than the amount of the proceeds, the total amount of the property at the time that its amount was lowest plus the amount of any proceeds later commingled with the property is to be treated as identifiable proceeds.

21. The law should provide that, where proceeds other than money have been commingled with other property of the same type so that the proceeds are not identifiable, the share of the total property which the value of the proceeds bears to the total value of the property is to be treated as identifiable proceeds.

[*Note to the Working Group: The Working Group may wish to note that recommendation 20 focuses on money as: (a) commingled proceeds other than money, is a fairly rare phenomenon; and (b) tracing rules for those situations are also rare. However, recommendation 21 might be applied in cases in which proceeds are fungible items that are commingled with other items of the same type (e.g. when the proceeds of a barter transaction consist of grain stored in a common grain elevator)*.]

B. Asset-specific recommendations

Effectiveness of a bulk assignment and an assignment of future, parts of and undivided interests in receivables[11]

22. 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.

[*Note to the Working Group: The Working Group may wish to note that the bracketed text in subparagraph (a) of this recommendation is intended to ensure that statutory limitations to the assignability of non-contractual receivables are not interfered with (see A/CN.9/603, para. 36 and notes to definition (p), "receivable", and recommendations 2, subparagraph (a), and 109). The Working Group may wish to consider all the definitions and recommendations on security rights in receivables together (i.e. definitions (a), (p)-(w) and recommendations 18-20, 22-24, 45, 108-118, 160-162, 172, 192, 197, 207 and 213). The Working Group may wish to note that the commentary will make clear that these recommendations, as well as all the other-specific recommendations, have to be read together*.]

[11] For recommendations 22-24, see A/CN.9/611, recommendations 14-16.

Effectiveness of an assignment made despite an anti-assignment clause

23. The law should provide that:

(a) An assignment 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;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that subparagraph (a) of this recommendation makes ineffective only an agreement between an obligor and an obligee that limits the obligee's right to assign a receivable owed by the obligor to the obligee. If such a receivable is assigned, the obligor is the "debtor of the receivable" and the obligee is the "assignor".*

For example, if an agreement for the lease of goods limits the lessor's right to assign the rents due to it under the lease, subparagraph (a) makes the limitation on assignment ineffective, because the agreement is between the obligor (the lessee) and the obligee (the lessor) of the receivable (the rent arising from the lease agreement). By way of contrast, if the lease agreement between the lessor and the lessee limits the lessee's right to assign a receivable consisting of the lessee's claim to rents due to the lessee from the sublessee under a sublease, subparagraph (a) has no application and nothing in the Guide makes the limitation ineffective. That is because the agreement limiting the right of the lessee to assign its claim for rents due to it from the sublessee under the sublease is not an agreement between the lessee (sublessor and obligee in a sublease) and the sublessee (obligor in the sublease). Whether the limitation in the lease is enforceable against the lessee would be determined by the law other than the law recommended in the Guide.

The same analysis would apply if the restriction on transfer was contained in a licence of intellectual property. Subparagraph (a), would render ineffective a term in the licence agreement that restricted the licensor from assigning fees due from the licensee. However, it would not render ineffective a term in the licence agreement restricting the licensee from assigning sublicense fees. Whether the latter term would be effective would be determined by law other than that recommended in the Guide.

The commentary will also explain that States that cannot protect themselves through statutory limitations on assignment may wish to consider an exception to this recommendation along the lines of article 40 of the United Nations Assignment Convention.]

(b) Nothing in this recommendation affects any obligation or liability of the assignor for breach of such an agreement, 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. 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;

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that the contract avoidance referred to in subparagraph (b) means contract termination in general*.]

Creation of a security right in a right that secures a receivable, a negotiable instrument or any other obligation

24. The law should provide that:

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

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

(c) This recommendation does not apply to a right in immovable property that under law other than this law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure;

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

(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 obligation 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 obligations:

(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;

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

(g) The rule in 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 obligation;

(h) To the extent that the automatic effects under subparagraph (a) of this recommendation and the automatic third-party effectiveness under recommendation 45 of a security right in any personal or property security right securing payment or other performance of a receivable, negotiable instrument or other obligation is not impaired, this recommendation does not affect any requirement under law other than this law relating to the form or registration of the creation of security rights in any assets, securing payment or other performance of a receivable, negotiable instrument or other obligation, that are outside the scope of this law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the purpose of this recommendation is to facilitate financing transactions, such as securitizations of pools of loans secured by security rights in movable and immovable property. In these cases the buyer of the loans will want to be able to look to the security rights securing the loans but would not want to incur, at the outset of the purchase, the additional expense of a separate act of transfer (if required under law other than the law recommended in the Guide) for each loan in the pool of loans, which could number in the hundreds or thousands. Separate acts of transfer, if any, would be necessary (if required under other law) to enforce only those loans which are later in default, typically a small proportion of the loans in the pool actually purchased. The buyer could decide whether to accept the expense of separate acts of transfer at the time of enforcement, whether voluntarily from the seller or with the assistance of a court. In deciding whether to purchase the loans and at what price, however, the buyer would take into account the expense of separate acts of transfer only for the small portion of the loans expected to be in default, not for the entire pool of loans. As a result of the expense savings, the seller should be able to obtain a higher purchase price, thereby making more funds available to the seller.*

The commentary will also make it clear that this recommendation applies to outright transfers of receivables (but not of negotiable instruments or other obligations), as the Guide generally applies only to outright transfers of receivables.

The commentary will also clarify that subparagraphs (a) to (c) track the language of article 10, paragraph (1), of the United Nations Assignment Convention with appropriate adjustments necessary in view of the nature of the law in the Guide as domestic law, while subparagraphs (e) and (f) track the language of

recommendation 23, subparagraphs (b) and (c), as well as article 10, paragraphs (3) and (4), of the United Nations Assignment Convention.

In addition, the commentary will clarify that subparagraph (g) tracks the language of article 10, paragraph (5), of the United Nations Assignment Convention, according to which, if the security right involves the delivery of possession of an asset and such delivery causes damage to the debtor of the receivable or the obligor of the negotiable instrument or other obligation, any liability that may exist under law applicable outside the law recommended in the Guide is not affected. Such liability may arise, for example, in the case of a delivery of possession of an item of valuable tangible property if the secured creditor or transferee damages or loses the property.

Furthermore, the commentary will clarify that subparagraph (h), which tracks the language of article 10, paragraph (6), of the United Nations Assignment Convention, makes it clear that the form of transfer of a security right in an asset outside the scope of this law (e.g. an immovable) is left to law other than this law, at least to the extent that the automatic creation and third-party effectiveness of a security right is not impaired. Accordingly, a notarized document and registration may be necessary for the transferee of a mortgage to obtain various rights under immovable property law, such as the right to enforce the mortgage. The commentary will further explain that the form of transfer of a security right in an asset within the scope of this law will be subject to this law.]

Creation of a security right in a negotiable instrument[12]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendations 12 and 13, a security right in a negotiable instrument may be created by a written and possibly signed agreement between the grantor and the secured creditor or by an oral agreement and transfer of possession of the negotiable instrument. The commentary will also explain that creation of a security right pursuant to these recommendations will not affect rights obtained by endorsement of the negotiable instrument under the law governing negotiable instruments.*

In addition, the Working Group may wish to consider all the definitions and recommendations on security rights in negotiable instruments together (i.e. definition (x), and recommendations 45, 89-90, 119, 163-164, 195, 209 and 213). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

Creation of a security right in a right to payment of funds credited to a bank account[13]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendations 12 and 13, a security right in a right to payment of funds credited to a bank account may be created by agreement between the grantor and the secured creditor. The commentary will also explain that the purpose of recommendation 25 is to validate as between the grantor*

[12] See A/CN.9/611/Add.1.

[13] See A/CN.9/611/Add.1, recommendation 26.

and the secured creditor (but not as against the depositary bank) a security right created in a right to payment of funds credited to a bank account despite an anti-assignment agreement between the depositary bank and the grantor (holder of the account).]

25. 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 a security right in its right to payment of funds credited to the bank account. 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary to recommendation 2, subparagraph (b), will clarify that enacting States may wish to take into account any impact that the recommendations in the Guide might have on consumer-protection law.*

In addition, the Working Group may wish to consider all the definitions and recommendations on rights to payment of funds credited to a bank account together (i.e. definitions (gg) and (hh), as well as recommendations 25, 46, 92-94, 120-121, 165-167, 208-209 and 213). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

Creation of a security right in proceeds under an independent undertaking[14]

26. The law should provide that a beneficiary may grant a security right in proceeds under an independent undertaking, even if the right to draw under the independent undertaking is itself not transferable under law and practice governing independent undertakings. The grant of a security right in proceeds under an independent undertaking is not a transfer of the right to draw under an independent undertaking. [Whether the right to draw under an independent undertaking may be transferred is a matter governed by the law and practice governing independent undertakings.]

[*Note to the Working Group: The Working Group may wish to note that the commentary will make clear that the second part of the first sentence clarifies the important point that transferability of an independent undertaking itself (i.e. the right to draw) is irrelevant to the right to create a security right in the proceeds under the independent undertaking. The commentary will also explain that the second sentence distinguishes a right to request payment under an independent undertaking from a right to receive the proceeds under an independent undertaking.*

The Working Group may wish to consider whether the bracketed third sentence should be part of the recommendation or the commentary as it states what other law provides and not what this law should provide. In addition, the Working Group may wish to consider all the definitions and recommendations on security rights in proceeds under an independent undertaking together (i.e. definitions (z) and (aa)-(ff), and recommendations 26, 47, 96, 122-124, 168 and 210-212). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

[14] See A/CN.9/611/Add.1, recommendation 25.

Creation of a security right in a negotiable document[15]

27. The law should provide that the creation of a security right in a negotiable document also creates a security right in the goods represented by the document, provided that the issuer is in possession of the goods, directly or indirectly, at the time the security right in the document is created.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that a security right in goods covered by a negotiable document may be created pursuant to recommendations 12 and 13 (by a written and possibly signed agreement between the grantor and the secured creditor or even by an oral agreement and transfer of possession of the document) directly in the goods or pursuant to recommendation 27 through the creation of a security right in the negotiable document covering the goods. In addition, the commentary will clarify that recommendation 27 is intended to obviate that, in situations where a security right exists in a negotiable document, a separate security right needs to be created in the goods covered by the document. Moreover, the commentary will explain that neither recommendations 12 and 13 nor recommendation 27 nor any other recommendation affects rights in negotiable documents acquired under the law governing negotiable documents.*

For the benefit of enacting States that may wish to consider addressing multi-modal transport documents, the commentary will also explain that, as the definition of a negotiable document in the Guide is left to the law governing negotiable documents, the negotiability of multi-modal transport documents is also left to that law. The Working Group may wish to consider all the definitions and recommendations on security rights in negotiable documents together (i.e. definitions (y), (oo) and (pp), and recommendations 27, 48-50, 97-98, 169, 125, 195 and 213). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

Creation of a security right in attachments[16]

28. The law should provide that a security right may be created in tangibles that are attachments at the time of creation of the security right or continue in tangibles that become attachments subsequently. Security rights in attachments to immovable property may be created under this law or law on immovable property.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, if the security right in attachments to immovable property is created under the law of immovable property, the security right may at the same time be effective against third parties. The commentary will also explain that, if such a security right is created under the secured transactions law, rights of persons that have rights under immovable property law may not be affected. For example, a security right created under secured transactions law may be enforced only if there are no competing rights created under immovable property law or has no priority over competing rights acquired under immovable property law (see recommendation 99).*

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[15] See A/CN.9/611/Add.1, recommendation 28.

[16] See A/CN.9/WG.VI/WP.26/Add.4, recommendation 31.

In addition, the Working Group may wish to consider all the definitions and recommendations on security rights in attachments together (i.e. definitions (l) and (m), as well as recommendations 28, 51-53, 99-102, 170, 189, 195 and 200-201). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

Creation of a security right in a mass or product[17]

29. The law should provide that a security right may not be created in tangibles that are commingled in a mass or product. However, a security right created in tangibles before they were commingled in a mass or product continues in the mass or product. The security right is limited to the value of the tangibles immediately before they became part of the mass or product.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that a security right may not be created in tangibles that are commingled in a mass or product as, at the time of creation of the security right, they do not exist as separate tangibles (see definition (n), "mass or product"). The commentary will also explain that a security right in the goods before they became commingled in a mass or product continues in the mass or product according to the formula contained in the third sentence of this recommendation. Under this formula, if the value of flour is 5 and the value of sugar is 5, while the value of the cake produced is 20 and there are two secured creditors, each secured creditor will get 5, while the remaining value of 10 will be preserved for the grantor and its unsecured creditors. If the value of the cake is lower than the value of the ingredients, the secured creditors will share the loss proportionately (e.g. if the value of the cake is 8, each secured creditor will get 4). This means that: (a) the secured creditor cannot get more than owed; and (b) if the value of the mass or product is less, the secured creditor will suffer a proportionate diminution (this is a priority issue).*

In addition, the Working Group may wish to consider all the definitions and recommendations on security rights in masses or products together (i.e. definition (n) and recommendations 29, 54, 103-105 and 195). The Working Group may also wish to note that the commentary will make clear that these recommendations have to be read together.]

V. Effectiveness of a security right against third parties[18]

Purpose

The purpose of the requirements of the law for the effectiveness of a security right against third parties is to create a foundation for the predictable, fair and efficient ordering of priorities 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

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[17] See A/CN.9/WG.VI/WP.26/Add.4, recommendation 32.

[18] See A/CN.9/WG.VI/WP.26/Add.5.

(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

Meaning of third-party effectiveness

30. The law should provide that a security right is effective against third parties only if it is created in accordance with this law and one of the methods referred to in recommendation 33, 35 or 36 has been followed.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendation 30 is intended to clarify the meaning of third-party effectiveness because of its importance for both the third-party effectiveness and the priority chapter and the fact that third-party effectiveness separate from effectiveness as between the parties is a new notion to many legal systems. Recommendation 30 is supplemented by recommendations 31 and 32 that further clarify the meaning of third-party effectiveness*.]

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

31. The law should provide that a security right that has been created in accordance with the provisions of the law on creation is effective against the grantor even if it is not effective against third parties.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a security right that is not effective against third parties has no effects as against general creditors or secured creditors whose security rights are not effective against third parties. This approach is consistent with the meaning of third-party effectiveness adopted in the Guide. The practical result of this approach is that no issue of priority arises in the case of security rights that are not effective against third parties and, therefore, such rights would be equal between them and with the rights of general creditors (unless they become judgement creditors, see recommendation 86)*.]

Continued effectiveness of a security right against third parties after a transfer of the encumbered asset

32. The law should provide that, except as provided in recommendations 82 to 84, after transfer of a right in an encumbered asset, a security right that is effective against third parties at the time of the transfer continues to encumber the asset and remains effective against third parties.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation reflects the rule that the mere transfer of an encumbered asset does not make a security right ineffective against third parties (droit de suite). This rule is restated somewhat differently in recommendation 81. The Working Group may wish to consider whether the rule should be stated in this chapter or in the chapter on priority*.]

General method for achieving third-party effectiveness of a security right

33. The law should provide that a security right created in accordance with the provisions of the law on creation 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 55-71.

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that registration of a notice of a security right is a pre-condition for it to become effective against third parties but does not create the security right, nor is it necessary to create a security right. Creation requires mainly an agreement between the parties as provided in the recommendations of the chapter on creation*.]

Alternative methods for achieving third-party effectiveness of a security right

35. The law should provide that a security right may also be made effective against third parties by one of the following alternatives to registration methods:

(a) In tangibles, by transfer of possession of an encumbered asset, as provided in recommendations 40 and 48-50;

(b) [In consumer goods of a value less than [specify value] at the time of creation of the security right, automatically upon creation of a non-acquisition security right (for acquisition security rights in consumer goods, see recommendation 185), as provided in recommendation 41];

(c) In movable property subject to registration in a specialized registry or notation on a title certificate, by such registration or notation, as provided in recommendation 42;

(d) In proceeds, automatically by achieving third-party effectiveness with respect to the proceeds, as provided in recommendations 43 and 44;

(e) In a personal or property right securing payment or other performance of a receivable, negotiable instrument or other obligation, by achieving third-party effectiveness with respect to the receivable, negotiable instrument or other obligation, as provided in recommendation 45;

(f) In a right to payment of funds credited to a bank account, by control, as provided in recommendation 46;

(g) In attachments, by registration as provided in recommendations 51-53; and

(h) In a mass or product by achieving third-party effectiveness [in a tangible before it becomes part of a mass or product] [in the mass or product within a certain time period after the tangible becomes part of the mass or product], as provided in recommendation 54.

Exclusive method for achieving third-party effectiveness of a security right in proceeds under an independent undertaking

36. The law should provide that, except as provided in recommendation 45, a security right in drawing proceeds under an independent undertaking is made effective against third parties only by control, as provided in recommendation 47.

Different third-party effectiveness methods for different types of asset

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

Continuity in third-party effectiveness of a security right

38. 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.

[*Note to the Working Group: The Working Group may wish to note that this recommendation makes no separate reference to registration (i.e. advance registration before creation), as, if there is a change in the method of third-party effectiveness before registration lapses, the security will have been created and thus made effective against third parties*.]

Lapse in advance registration or third-party effectiveness of a security right

39. The law should provide that, if notice of a security right has been registered or made effective against third parties and subsequently there is a period at which the security right is neither registered nor effective against third parties, registration or third-party effectiveness may be re-established. In such a case, registration or third-party effectiveness dates from the earliest time thereafter at which the security right is either registered or made effective against third parties.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that reference is made in this recommendation to registration separately from third-party effectiveness as registration may be made before the creation of a security right (see recommendation 64), while third-party effectiveness requires creation of the security right and completion of a method of third-party effectiveness (see recommendation 31).*

The Working Group may wish to note that this recommendation tracks the language of recommendations 77 and 78, under which priority dates from the time when third-party effectiveness is re-established or a notice with respect to the security right is registered. The Working Group may wish to consider whether the first sentence of recommendation 39 should be retained in this chapter as it deals with the lapse of registration or third-party effectiveness and the second sentence should be reflected only in the chapter on priority as it essentially deals with priority.

The Working Group may also wish to note that the commentary will explain that third-party effectiveness may lapse where, for example, the secured creditor does not renew its registration before expiry of its initial term or where third-party

effectiveness was obtained by delivery of possession of the encumbered assets to the secured creditor but the secured creditor later returns possession to the grantor. The commentary will also explain that third-party effectiveness does not lapse in such cases if the security right is registered or made effective against third parties before the lapse of the particular method of third-party effectiveness.

The commentary will include the following examples of situations where continuity in third-party effectiveness is preserved notwithstanding lapse in a particular method of third-party effectiveness:

(a) On day 1, the grantor creates a security right in favour of the secured creditor who on the same day takes possession of the encumbered assets. On day 2, the secured creditor registers a notice about its security right and then relinquishes possession. Third-party effectiveness is continuous from day 1;

(b) On day 1, the grantor creates a security right in favour of the secured creditor on day 1 who, on the same day, registers a notice of its security right. On day 2, the secured creditor takes possession of the encumbered assets while registration lapses on day 3. Third-party effectiveness is continuous from day 1. The result is the same if the secured creditor registers again on day 4 and surrenders possession of the encumbered assets to the grantor on day 5.]

Third-party effectiveness of a security right in tangibles by possession

40. The law should provide that a security right in tangibles may also be made effective against third parties through possession.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, as the term "tangibles" covers negotiable instruments and negotiable documents (see definition (i)), this recommendation applies to third-party effectiveness of security rights in negotiable instruments and negotiable documents. As a result, a security right in a negotiable instrument or in a negotiable document may be made effective against third parties by registration or possession. Recommendations 48 to 50 add special rules with respect to third-party effectiveness of security rights in negotiable documents and goods covered by negotiable documents*.]

[**Third-party effectiveness of a non-acquisition security right in low-value consumer goods**

41. A non-acquisition security right in consumer goods of a value less than [specify value] at the time of creation of the security right (for acquisition security rights in consumer goods, see recommendation 185) that is not subject to a specialized registration or title certificate system is effective against third parties automatically upon creation of the security right.]

[*Note to the Working Group: The Working Group may wish to note that, as there is no significant financing that involves non-acquisition security rights in consumer goods, there was broad support in the Commission at its thirty-ninth session for the deletion of recommendation 41 (and, therefore, recommendation 35, subparagraph (b); see A/61/17, para. 25). If this recommendation is retained, the Working Group may wish to consider that, as low value in one country may be high value in another country, the determination of low value should be based on a*

cost-benefit analysis that compares the potential realization value of an asset to the cost of registration.]

Third-party effectiveness of a security right in movables with respect to which there is a specialized registration or a title certificate system

42. The law should provide that a security right in movable property that is subject to registration in a specialized registry or notation on a title certificate under law other than this law may also be made effective against third parties by:

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that registration in a specialized registry may have constitutive rather than third-party effects and may involve registration of documents rather than a mere notice. The commentary will also explain that recommendation 42 is formulated to avoid addressing that issue which is a matter for other law. In addition, the commentary will explain that registration in the general security rights registry and registration in the specialized registry are the only available methods for achieving third-party effectiveness of a security right in movable property of the kind referred to in this recommendation (i.e. third-party effectiveness may not be achieved by possession), if so provided in the relevant special legislation (for attachments subject to specialized registration, see recommendation 53).*

The commentary will also explain that recommendation 42 is supplemented by recommendation 79, under which a security right registered in the specialized registry or with respect to which a notation was made in a title certificate has priority over a security right registered in the general security rights registry. Consequently, to ensure maximum priority over all classes of competing creditors, the security right should be made effective by registration in accordance with recommendation 42 rather than recommendation 33. This approach is justified by the need to preserve the reliability of the specialized registry or title certificate system for buyers of encumbered assets or secured creditors that rely on these systems to ensure protection of their rights.]

Third-party effectiveness of a security right in proceeds[19]

Alternative A

43. 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 is effective against third parties when the proceeds arise, provided that:

(a) The security right in the encumbered asset was made effective against third parties by registration of a notice in the general security rights registry, registration in a specialized registry or notation on a title certificate and remains effective at that time; or

[19] For recommendations 43 and 44, see A/CN.9/WG.VI/WP.26/Add.4, recommendations 41 and 41 bis.

[*Note to the Working Group: The Working Group may wish to note that subparagraph (a) would not apply, for example, to a security right that was made effective against third parties by possession. The residual rule in recommendation 44 would apply to such a right. The Working Group may also wish to note that, at its thirty-ninth session, the Commission referred the alternatives to the Working Group with a view to trying, to the extent possible, to reach agreement on one of them (see A/61/17, para. 26)*.]

(b) The proceeds are money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

44. If recommendation 43 does not apply, the security right in the proceeds is effective against third parties for […] 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 33 or 35 before the expiry of that time period.

Alternative B

43. 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 is effective against third parties when the proceeds arise, provided that the proceeds are money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

44. If recommendation 43 does not apply, the security right in the proceeds is effective against third parties for […] 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 33 or 35 before the expiry of that time period.

[*Note to the Working Group: The Working Group may wish to note that, in view of the difference of opinion in the Working Group as to whether the right in proceeds should be automatically effective or whether a separate act of third-party effectiveness should take place when the proceeds arose (see A/CN.9/593, paras. 26-32), recommendation 43 includes two alternatives.*

Under alternative A, a security right in proceeds is automatically effective against third parties, if the security right in the originally encumbered assets was made effective against third parties by registration or if the security right was in money and the like. If the security right was made effective against third parties by possession, according to recommendation 44, the security right in the proceeds would be effective for a short period of time and thereafter only subject to a separate act of third-party effectiveness.

Under alternative B, automatic third-party effectiveness would be limited to proceeds in the form of money and the like, while recommendation 44 would apply to all other cases. As a result of this approach, a security right in proceeds would remain effective against third parties for a few days after the proceeds arose and thereafter only if a notice was registered with respect to the security right in the proceeds or by possession. The commentary will clarify that civil and natural fruits are automatically covered as they are defined as "proceeds" (see definition (jj)).

The Working Group may also wish to consider that, to balance the needs to protect a secured creditor and third parties, the time period referred to in recommendation 44 should be as short as the grace period in the third-party

effectiveness recommendation applicable to acquisition security rights (i.e. 20-30 days, see recommendation 184).]

B. Asset-specific recommendations

Third-party effectiveness of a security right in a right that secures a receivable, negotiable instrument or any other obligation[20]

45. The law should provide that, if a security right in a receivable, negotiable instrument or any other obligation covered as an encumbered asset by this law is effective against third parties, the security right is automatically effective against third parties with respect to any personal or property right that secures payment or performance of the receivable, negotiable instrument or other obligation, without further action by either the grantor or the secured creditor. If the personal or property right is an independent undertaking, a security right in the proceeds under the independent undertaking is automatically effective against third parties (but, as provided in recommendation 24, subparagraph (b), the security right does not extend to the right to draw under the independent undertaking). This recommendation does not apply to a right in immovable property that under law other than this law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general third-party effectiveness recommendations apply to security rights in receivables, as well as to outright transfers of receivables. The commentary will also explain that the language in parenthesis in the second sentence explains that the security right does not extend to the right to draw (i.e. to demand payment) under an independent undertaking. As there is no security right in the right to draw, there is no issue of third-party effectiveness in that regard.*]

Third-party effectiveness of a security right in a right to payment of funds credited to a bank account[21]

46. The law should provide that a security right in a right to payment of funds credited to a bank account may also be made effective against third parties by the secured creditor obtaining control with respect to the right to payment of funds credited to the bank account.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendation 33, a security right in a right to payment of funds credited to a bank account may also become effective against third parties by registration of a notice in the general security rights registry.*]

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[20] See A/CN.9/611, recommendation 37.

[21] See A/CN.9/611/Add.1, recommendation 43.

Third party effectiveness of a security right in proceeds under an independent undertaking[22]

47. The law should provide that, except as provided in recommendation 45, a security right in proceeds under an independent undertaking may be made effective against third parties only by the secured creditor obtaining control with respect to the proceeds under the independent undertaking.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that neither possession of an independent undertaking nor registration of a notice should be a method of achieving third-party effectiveness of a security right in a right to proceeds under an independent undertaking. Possession of an independent undertaking (even when it is in tangible form) plays only a limited role in the modern use of independent undertakings. In addition, if possession were included in the Guide as a method of achieving effectiveness against third parties, there would be a need for complex rules dealing with priority and conflict of laws. It should be noted, however, that, although possession does not constitute a method of achieving effectiveness against third parties, as a practical matter, possession would give protection to a secured creditor when the terms of the independent undertaking require the physical presentation of the independent undertaking to make a draw under the independent undertaking. In such a circumstance, the beneficiary could not make an effective draw without the secured creditor's cooperation, so the secured creditor could take steps to assure itself of payment (e.g. the secured creditor could require the beneficiary to obtain an acknowledgement that would achieve control for the secured creditor before surrendering the independent undertaking and allowing it to be presented to the guarantor/issuer or nominated person that gave the acknowledgement)*.]

Third-party effectiveness of a security right in a negotiable document[23]

48. The law should provide that a security right in a negotiable document may also be made effective against third parties by the secured creditor obtaining possession of the document.

49. The law should provide that, if a security right in a negotiable document is effective against third parties, the corresponding security right in the goods covered by the document is also effective against third parties. As long as a negotiable document covers goods, a security right in the goods may be made effective against third parties by the secured creditor obtaining possession of the document.

50. The law should provide that a security right in a negotiable document that was made effective against third parties by the secured creditor obtaining possession of the document remains effective against third parties for a short period of [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 goods covered by the negotiable document.

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[22] See A/CN.9/611/Add.1, recommendation 49.

[23] See A/CN.9/611/Add.1, recommendations 44-44 ter.

Third-party effectiveness of a security right in attachments[24]

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

52. The law should provide that a security right in an attachment to immovable property may also be made effective against third parties by registration in the immovable property registry.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in accordance with recommendation 33, a security right in a tangible that is an attachment when the security right is made effective against third parties or becomes an attachment subsequently may be made effective against third parties by registration of a notice in the general security rights registry. The commentary will also explain that recommendation 51 is intended to clarify that no additional step is necessary to make effective against third parties a security right in an attachment that was effective against third parties before the tangible became an attachment. In addition, the commentary will explain that recommendation 52 makes it clear that a security right in an attachment to immovable property may be made effective against third parties by registration in the general security rights registry or in the immovable property registry.*

This recommendation is designed to protect the integrity and reliability of the immovable property registry. It is supplemented by recommendation 99, pursuant to which a security right in attachments to immovable property made effective against third parties in accordance with immovable property law has priority over a security right in such attachment made effective against third parties in accordance with this law. Recommendation 52 is also supplemented by recommendation 100, pursuant to which a security right in attachments to immovable property, which became effective against third parties by registration in the immovable property registry under recommendation 52 has priority over a security right in the related immovable that was registered subsequently. The commentary will also explain that, if a security right in an attachment to immovable property is made effective against third parties under this recommendation, what is registered is, in principle, a matter of immovable property law. However, the attention of the legislator may have to be drawn to the need to amend immovable property law so as to permit registration of a notice about a security right rather than only notarial documents. One difficulty in third parties finding that notice is that registration in the immovable property registry is made against the asset and not the grantor.

The commentary will further explain that the security right will be in the immovable property as a whole but the notice should describe the attachment and priority should be limited to the value of the attachment, if it were detached. The question whether the attachment could be detached and how the secured creditor would be paid would also need to be addressed as a matter of enforcement (see recommendation 170). The Working Group may wish to consider whether a creditor with a right acquired under immovable property law should have a right to pay off the debt owed to the secured creditor with a security right acquired under movable property law. This matter may be left to inter-creditor agreements.

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[24] See A/CN.9/WG.VI/WP.26/Add.4, recommendations 45 and 46.

The commentary will also discuss approaches taken in recent legislation under which a security right in an attachment is registered only in the general security rights registry and the registry forwards a notice of such registration to the immovable registry.]

Third-party effectiveness of a security or other right in attachments to movable property subject to a specialized registration system or title certificate system[25]

53. The law should provide that a security right in an attachment to movable property that is subject to registration in specialized registry or notation on a title certificate under law other than this law may also be made effective against third parties by:

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

[*Note to the Working Group: The Working Group may wish to note that this recommendation tracks the language of recommendation 42*.]

Third party effectiveness of a security right in a mass or product[26]

Alternative A

54. The law should provide that, if a security right in a tangible is effective against third parties when it becomes part of a mass or product, the security right in the mass or product created under this law as provided in recommendation 29 is effective against third parties thereafter without the need for any further act.

Alternative B

54. The law should provide that, if a security right in a tangible is effective against third parties when it becomes part of a mass or product, the security right in the mass or product created under this law as provided in recommendation 29 is effective against third parties thereafter for […] days after the mass or product is created. The security right remains effective against third parties thereafter if it is made effective against third parties by one of the methods referred to in recommendation 33 or 35 before the expiry of that time period.

VI. The registry system[27]

Purpose

The purpose of the provisions of the law 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:

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[25] See A/CN.9/WG.VI/WP.26/Add.4, recommendation 46 bis.
[26] See A/CN.9/WG.VI/WP.26/Add.4, recommendation 47.
[27] See A/CN.9/WG.VI/WP.26/Add.5.

(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) A basis for priority rules that depend on the time when third-party effectiveness of a security right is achieved; 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.

The registry system should be designed to ensure that the registration and searching process is simple, time- and cost-efficient, user-friendly and publicly accessible.

[*Note to the Working Group: The Working Group may wish to note that the commentary will relate the purpose section of this chapter to recommendations 12 and 13 (creation), 30 (distinguishing creation from third-party effectiveness), 34 (making the point that registration does not create a security right), 42 (registration in a specialized registry) and 64 (making the point that registration may take place before creation of a security right).*

The commentary will also explain that registry systems that: (a) require registration of documents (rather than of a notice as provided in recommendation 55, subparagraph (b) and 58); (b) require scrutiny or verification of the documents (rather than no scrutiny or verification by anybody other than the registrant as provided in recommendation 55, subparagraph (c)); (c) have constitutive effects (rather than the effects described in recommendation 33 or 35); and (c) require high (e.g. ad valorem) registration fees (rather than nominal fees based on cost recovery as provided in recommendation 55, subparagraph (h)) are not suitable for a speedy, efficient, inexpensive and user-friendly registry, which is crucial for a secured transactions law in movable property that promotes increased access to lower-cost credit.]

Operational framework of the registration and searching process

55. The law should provide an administrative framework to ensure that the registration and searching process operates as follows:

(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, containing the information specified in recommendation 58, as opposed to a copy of the underlying security agreement or other document;

(c) A notice may be registered without verification or scrutiny by anybody other than the registrant;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that false or misleading notices could be cancelled under recommendation 68, while the question whether any penalties for knowingly registering a false or misleading notice should be imposed is left to tort, penal or*

other law. The commentary will also provide guidance as to types of possible penalty.]

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

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

(f) 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, such as State-issued identification or commercial registration number;

(g) The registry is open to the public;

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

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

(j) The registry operates reliable and consistent service hours compatible with the needs of potential registry users; and

(k) To the extent the infrastructural capacity of the State permits, the registration system is computer-based. 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 Internet and electronic data interchange;

(iii) The system is programmed to minimize the risk of entry of incomplete or irrelevant information (e.g. by requiring essential data fields to be completed); and

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

Security and integrity of the registry

56. In order to ensure the security and integrity of the registry record, the operational and legal framework of the registry should reflect the following characteristics:

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

(b) The identity of a registrant is requested and entered into the registry record;

(c) [The registry] [The secured creditor] is obligated to forward a copy of a notice to the grantor named in the notice;

(d) The registry is obligated to send a copy of any changes to a notice to the secured creditor named in the notice;

(e) 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; and

(f) The registry record can be reconstructed.

Responsibility for loss or damage

57. 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 should be limited to a system malfunction.

Required content of notice

58. The law should provide that the notice must contain only:

(a) The identity of the grantor, as provided in recommendations 59-61, and the secured creditor or its representative and their addresses;

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

(c) The duration of the registration as provided in recommendation 64; and

[(d) A statement of the maximum monetary amount for which the security right may be enforced [if the State determines that such information is helpful to facilitate subordinate lending.]]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, while the meaning of the term "representative" may be subject to law other than this law, it includes agent, trustee or other person acting on behalf or in favour of the secured creditor*.]

Sufficiency of grantor identifier

59. The law should provide that a notice is effective only if it states the grantor's correct identifier or, in the case of an incorrect statement, if the notice can be retrieved by searching the registry record according to the correct identifier.

60. 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, such as a birth certificate, identity card or passport. Where necessary, additional information, such as the birth date or identity card number, should be required to uniquely identify the grantor.

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that where the name of the grantor is listed in a separate record maintained by the State, for example, a commercial or company register, the State may wish to set up links between the two registers to facilitate accurate data entry. The commentary will also explain that an identifier other than the name*

(e.g. birth date) is required for natural persons to distinguish between natural persons with the same name. Such identifier is not required for corporations as their name has to be unique to be accepted by the company registry.]

Change of the grantor's identifier

62. The law should provide that, if the identifier of the grantor used in the notice changes after the notice is registered:

(a) A security right in an encumbered asset in which the grantor has rights at the time of the change remains effective against third parties;

(b) A security right in an asset acquired by the grantor or created within […] days after the time of the change is effective against third parties; and

(c) A security right in an asset acquired by the grantor or created more than […] days after the time of the change is not effective against third parties unless the notice is amended to provide the new identifier of the grantor.

[*Note to the Working Group: The Working Group may wish to consider the following alternatives to recommendation 62:*

"Alternative A

The law should provide that, if the identifier of the grantor changes after a notice is registered, the security right remains effective against third parties until the grantor notifies the secured creditor of the name change. The secured creditor then has [...] days to amend the notice. Failure to do so means that the security right is ineffective against secured creditors that register and buyers that acquire a right in the encumbered asset after the expiry of the time period, unless the secured creditor amends the notice before the competing security right is registered or the buyer acquires a right in the asset.

Alternative B

The law should provide that, if the identifier of the grantor changes after a notice is registered, the secured creditor has […] days to amend the notice. Failure to do so means that the security right is ineffective against secured creditors that register and buyers that acquire a right in the encumbered asset after the expiry of [...] days from the time of the change, unless the secured creditor amends the notice before the competing security right is registered or the buyer acquires a right in the asset."

In addition, the Working Group may wish to note that the commentary will provide guidance as to the length of the time period referred to in recommendation 62 (e.g. 60, 90 or 120 days). The commentary will also discuss various circumstances in which an entity may change its name (e.g. merger or acquisition).]

Sufficiency of description of assets covered by a notice

63. The law should provide that a description of the assets covered by a notice is sufficient if it identifies the assets covered by the notice in a manner that distinguishes those assets separately from other assets of the grantor. A generic description of the encumbered assets is sufficient.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that descriptions such as "all inventory" or "all present and future assets" would be sufficient.*]

Time of registration

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.

[*Note to the Working Group: The Working Group may wish to note that the purpose of this recommendation is to confirm that registration may take place before creation of the security right. The commentary will explain that the purpose of allowing advance registration is to enable secured creditors to ensure their priority position by registering (especially as against potential competing claimants) at the earliest time possible in order to facilitate the extension of credit upon conclusion of the formal security agreement (see also recommendation 76, according to which priority dates back from the time of registration (i.e. before creation of a security right, assuming that a security right comes into existence subsequently) or at the time of third-party effectiveness (i.e. creation plus registration or possession). The commentary will also explain that the grantor is not affected by inaccurate or false notices as they do not produce any legal consequences and, in any case, the debtor may always seek a cancellation of the notice under recommendation 68 or exercise other remedies under tort, penal or other law.*]

One notice for multiple security agreements between the same parties

65. The law should provide that registration of a single notice is sufficient to ensure the third-party effectiveness of security rights created or to be created by all security agreements entered into between the same parties to the extent they cover items or kinds of movable property that fall within the description contained in the notice.

Duration and extension of notice

66. The law should specify the duration of a notice or else permit the registrant to select the duration of a notice at the time of registration and extend it at any time before its expiry.

Time of effectiveness of notice or amendment

67. The law should provide that a notice or its amendment takes effect when the information contained in the notice or its amendment is entered into the registry record so as to be available to searchers of the registry record.

[*Note to the Working Group: The Working Group may wish to note that, if the registration system permits the submission of paper notices to the registry (as opposed to direct data entry by registrants), there will be some delay between receipt of the notice by the registrar and the time the information on the notice is entered into the record by registry staff so as to become available to searchers. In such circumstances, the question arises as to the time when the registration should be effective, the time of receipt of the notice at the registry or the time the notice is entered into the record and becomes available to searchers. If the registration is*

effective when received by the registrar, a search will not disclose all legally effective registrations. To protect the information needs of third parties, therefore, this recommendation makes the time of registration concomitant with searchability. Although this puts the risk associated with any delay on the secured creditor, the secured creditor is in a better position to take steps to protect itself than third parties. Moreover, the recommendations earlier outlined on the design and operation of the registry should ensure speedy and efficient registration procedures. In a fully electronic system that requires no intervention by registry staff, entry of the notice and its availability to searchers is virtually simultaneous and this problem is significantly reduced.

The Working Group may also wish to note that the commentary will explain that an amendment may involve various changes, such as: (a) adding or deleting items or kinds of encumbered assets; (b) adding or deleting the identifier of a grantor; (c) recording a change in the identifier of a grantor or secured creditor; (d) disclosing an assignment of the security right by the secured creditor named in the original registration to a new secured creditor; or (e) disclosing a subordination agreement or undertaking that affects a registered security right.]

Cancellation or amendment of notice

68. The law should provide that, if no security agreement has been completed, the security right has been terminated [by full payment or otherwise] or the notice contains information not authorized by the grantor:

(a) The secured creditor must cancel or amend the notice within […] days after the written request of the grantor;

(b) The grantor is entitled to compel cancellation or amendment of the notice through a summary procedure;

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the grantor may seek to cancel the notice under subparagraph (b) even before expiry of the period referred to in subparagraph (a). In such a case, however, the grantor may have to bear any costs involved (see A/CN.9/593, para. 54). The Working Group may also wish to note that the commentary will provide guidance to States as to the length of the time period referred to in this recommendation (e.g. 20-30 days)*.]

69. The law should provide that the secured creditor is entitled to cancel or amend a notice at any time.

70. The law should provide that, where a notice has been cancelled, the record of the notice should be removed from the searchable records of the registry within a short time after its cancellation. However, the information in the cancelled notice and the fact of the cancellation should be archived so as to be capable of retrieval if necessary.

71. [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] [to remain effective, the notice must be amended to indicate the name of the new secured creditor].]

[*Note to the Working Group: The Working Group may wish to consider which of the alternatives reflected in this recommendation within square brackets is preferable (see A/CN.9/593, para. 56)*.]

VII. Priority of a security right as against the rights of competing claimants[28]

Purpose

The purpose of the provisions of the law on priority is to:

(a) Provide an efficient and predictable regime to determine the order of priority of a security right as against the rights of all possible competing claimants; and

(b) 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

Extent of priority

72. The law should provide that the priority of a security right extends to all obligations secured under the security agreement [up to the maximum monetary amount indicated in the notice].

Irrelevance of knowledge of the existence of the security right

73. The law should provide that knowledge of the existence of a security right on the part of a competing claimant does not affect its rights under the provisions of the law on priority.

Priority of security rights securing future obligations

74. [Subject to recommendation 86,] the priority of a security right does not depend on the date when the secured obligation was incurred.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that if a security right securing a credit facility is made effective against third parties on day 1 and credit is extended on day 2 and then on day 3 and 4, priority dates back from the time the security right was made effective against third parties (i.e. day 1). The commentary will also explain that an exception to this rule is stated in recommendation 86, which provides that, if the secured obligation was incurred after a judgement creditor acquires rights in the encumbered asset, the security right is subordinate to the rights of the judgement creditor. The Working Group may wish to consider whether further exceptions should be introduced (e.g. the super-priority of an acquisition security right should*

[28] See A/CN.9/WG.VI/WP.26/Add.6.

be limited to secured obligations incurred up to the time of the acquisition of the relevant assets by the transferee).]

Subordination agreements

75. 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will make clear that, under this recommendation, a subordination agreement would be possible not only between competing claimants with a different priority ranking but also between competing claimants with the same priority ranking (see A/CN.9/593, para. 61). The Working Group may also wish to note that subordination agreements in the case of the grantor's insolvency are addressed in recommendation 179*.]

Priority between security rights in the same encumbered assets

76. The law should provide that, except as provided in recommendations […], a security right in movable property registered or made effective against third parties, whichever occurs first, has priority over a security right in the same property subsequently registered or that is made effective against third parties. The date of registration determines priority of a security right with respect to all encumbered assets irrespective of whether they are acquired by the grantor or come into existence before, on or after the date of registration.

[*Note to the Working Group: The Working Group may wish to note that the commentary will make clear that the reference to registration means registration before creation of a security right pursuant to recommendation 64, while the reference to third party effectiveness means creation plus a step to achieve third party effectiveness pursuant to recommendation 33, 35 or 36. The commentary will also explain that issues of priority arise where there are competing rights in the same assets, the debtor defaults on the secured obligation and the value of the encumbered assets is not sufficient to satisfy all secured obligations. The commentary will also make clear that:*

(a) As between two security rights registered in the general security rights registry, the first registered wins;

(b) As between two security rights registered in a specialized registry or noted on a title certificate, the first registered wins;

(c) As between a security right registered in the general security rights registry and a security right registered in a specialized registry or noted on a title certificate, the latter wins (as a result of recommendation 79); and

(d) As between a security right registered (in advance of creation) in the general security rights registry or in a specialized registry or noted on a title certificate and a security right (created and) made effective against third parties, the first registered or made effective against third parties wins.

In addition, the Working Group may wish to note that the commentary will also clarify that, if a security right is not effective against third parties, no issue of

priority arises and, therefore, such security rights have the same ranking. The commentary will also explain that recommendation 76 applies to a conflict between two security rights in the same encumbered assets (as to whether it should apply to conflicts with a buyers and judgement creditor, see note to recommendation 82).

Moreover, the Working Group may wish to note that the commentary will also explain that the reasons why a security right registered in advance of its creation is given priority as of the time of registration are to encourage advance registration (which provides notice to third parties) and to provide certainty to secured creditors by enabling them to determine the priority of their security rights before they extend credit. This reason does not apply to advance possession. Furthermore, such a rule would not be necessary with respect to negotiable instruments and negotiable documents, since possession of them gives a superior right than is obtained by registration (see recommendations 89, 90, 97 and 98). As to other tangibles, the assumption is that advance possession is not practised (delivery of possession will always be based on an agreement about the security right). Accordingly, no general rule along the lines of recommendation 76 is introduced with respect to advance possession. The Working Group may wish to consider whether there are substantial financing practices in which the secured creditor may take possession of the encumbered assets in advance of such agreement and, if so, whether the secured creditor that took advance possession should have priority as of that time (see A/CN.9/593, para. 68).]

Continuity in priority

77. The law should provide that 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.

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

[*Note to the Working Group: The Working Group may wish to note that, under recommendation 39, third-party effectiveness is continuous. If it lapses, it dates back from the time it was re-established (see also examples set forth in the note to recommendation 39).*]

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

79. The law should provide that a security right or other right (such as the right of a buyer or lessor) in movable property other than attachments that is made effective against third parties as provided in recommendation 42 has priority over:

(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 any other method regardless of the order; and

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

Priority of a security right in proceeds[29]

80. Except as provided in recommendations […], the law should provide that a security right in the proceeds of an encumbered asset that is effective against third parties has the same priority as the security right in the encumbered asset.

Rights of buyers, lessees and licensees of encumbered assets

81. The law should provide that, if a security right is effective against third parties, the security right continues in the encumbered assets in the hands of a third party except as provided in recommendations 82, 83 and 84.

[*Note to the Working Group: The Working Group may wish to note that this recommendation is designed to state the rule that the secured creditor may follow the asset in the hands of a transferee (droit de suite, a rule stated somewhat differently in recommendation 32*.]

82. 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 [:

(i)] The secured creditor authorizes the sale or other disposition free of the security right [; or

(ii) In the case of a security right registered before creation, the secured creditor has knowledge of the sale]; and

(b) The rights of a lessee or licensee of an encumbered asset are not affected by a security right if [:

(i)] The secured creditor authorizes the grantor to lease or license the asset [unaffected by the security right] [; or

(ii) In the case of a security right registered before creation, the secured creditor has knowledge of the lease or licence.]

[*Note to the Working Group: The Working Group may wish to note that the formulation of subparagraph (b) of this recommendation has been changed to address a concern expressed at the thirty-ninth session of the Commission (see A/61/17, para. 37; for the same reason, similar changes were made to the formulation of recommendations 83, subparagraphs (b) and (c), and 84, second sentence) and the matter is addressed in the following paragraphs of this note.*

Under recommendation 76, registration of a notice before the creation of a security right gives priority over another security right that was (created and) made effective against third parties later. The Working Group may wish to consider whether this recommendation should apply to priority conflicts between a secured creditor and a buyer, lessee or licensee of encumbered assets acquiring a right in the assets after registration of a notice but before actual creation of a security right in them. It may be considered that the buyer, lessee or licensee should take free of the security right in these circumstances on the basis that by the time the security right is created, the encumbered assets are no longer owned by the seller or are subject to the possession or use rights of the lessee or licensee. The disadvantage of

[29] See A/CN.9/WG.VI/WP.26/Add.4, recommendation 67.

such an approach would be that the secured creditor would then be able to rely on its act of advance registration to preserve priority only as against other secured creditors. As against intervening transferees, the secured creditor would have to undertake further inquiries before being able to safely advance credit once the security right comes into existence.

A similar issue arises when a judgement creditor acquires rights in the encumbered assets after advance notice of a security right is registered but before the security right is actually created. The considerations are somewhat different in this case, since a secured creditor is not subordinated to the rights of the judgement creditor, under the recommendations in this chapter, until it acquires actual knowledge of the judgement creditor's rights and is then subordinated for advances made after receiving knowledge. Consequently, if the security right has not yet been created when the judgement creditor advises the secured creditor of its intervening rights, the secured creditor can protect itself either by requiring the grantor to discharge the judgement or by reducing the credit the secured creditor plans to extend. A similar rule could be adopted for intervening buyers. Under this approach, a buyer, lessee or licensee of assets would take free of a prior-registered security right that has not yet come into existence provided the secured creditor had knowledge of the sale, lease or licence. Buyers, lessees and licensees could then protect themselves by giving notice of their transaction rather than having to secure a positive waiver of priority from the secured creditor. The secured creditor would likewise be protected because it would have actual knowledge of the intervening transaction before entering into the security agreement. The language included in square brackets in subparagraphs (a) (ii) and (b) (ii) are intended to address this point.

The Working Group may also wish to note that application of the rule in recommendation 82 requires a comparison of the date at which a security right was made effective against third parties with the date of the sale, lease or licence of the encumbered asset (as a security right that was not effective against third parties would not produce effects as against buyers, lessees or licensees). While the date at which the security right was made effective against third parties will usually be obvious (inasmuch as the registry's records will reveal when a notice was registered), it may not be clear when a sale has taken place. For example, a contract to sell goods that are encumbered assets may have been entered into between the grantor/seller and the buyer on date 1, they may have been shipped to the buyer on date 2 (either because the contract provided for shipment on that date or otherwise), the goods may have been received by the buyer on date 3 and the buyer may have paid for them on date 4; under applicable law, the sale by the grantor/seller to the buyer may have occurred on any of those dates or on still another date. Application of the rule in recommendation 82 requires knowing which of those dates is the date on which the sale took place because the date that the security right was made effective against third parties might precede some but not all of those dates. The Working Group may thus wish to consider whether recommendation 82 (or the commentary accompanying it) should provide additional guidance as to when a sale should be considered to have taken place for purposes of determining the status of the buyer's rights to the goods as against the secured creditor. The commentary will also make clear that, if the grantor of an asset sells it with a retention of title, the buyer takes free of the retention of title when it pays the

price. Before that, the retention-of-title seller has the rights of an owner (or secured creditor, depending on whether a unitary or a non-unitary approach is followed).]

83. The law should also provide that:

(a) A buyer in the ordinary course of business [and a buyer of consumer goods] takes free of a security right;

(b) The rights of a lessee in the ordinary course of business are not affected by a security right; and

(c) The rights of a licensee in the ordinary course of business under a non-exclusive license are not affected by a security right.

[*Note to the Working Group: The Working Group may wish to note that, according to definition (uu), "buyer in the ordinary course of business" is a buyer of inventory in the ordinary course of business that has no knowledge that the sale violates a security or other right. The Working Group may also wish to recommend that buyers of consumer goods [of low value] that have no knowledge of a security right in the goods should take free of a security right in the goods. In that connection, the Working Group may wish to take into account that such buyer would have no way of finding out about the existence of a security right in the goods as, under recommendations 41 and 185, non-acquisition security rights in low-value consumer goods and acquisition security rights in consumer goods are exempt from registration (see A/CN.9/593, para. 77). With respect to paragraphs (b) and (c), the commentary will explain that the security right does not cease to exist but that, for the duration of the lease or license, the right of the secured creditor was limited to the lessor's or licensor's interest*.]

84. The law should provide that, where a buyer or transferee acquires an encumbered asset free of a security right, any person that subsequently acquires a right in that asset from that buyer or transferee also takes free of the security right. Where the rights of a lessee or licensee are not affected by a security right, the rights of a sublessee or sublicensee are also unaffected by the security right.

Priority of preferential claims

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

[*Note to the Working Group: The Working Group may wish to consider whether buyers, lessees and licensees should take free of any preferential claims. As this question does not involve a priority conflict with a security right, it may be addressed in the commentary*.]

Priority of rights of judgement creditors

86. The law should provide that [, except as provided in recommendation 188,] a security right has priority over the rights of an unsecured creditor, provided that it was made effective against third parties before the unsecured creditor [, under law other than this 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. The priority of the security right extends to credit extended by the secured creditor within a specified period of days after the unsecured creditor notified the secured creditor of the existence of the unsecured creditor's rights in the assets but does not extend to credit extended after the expiry of that period.

[*Note to the Working Group: The Working Group may wish to consider: (a) whether it is possible for a security right in a particular asset to become effective against third parties at the same time that an unsecured creditor acquires, by reason of judgement or provisional court order, a right in that asset; and (b) if so, which of those rights has priority over the other.*

The problem is most important in the case of a security right in future assets of a grantor. The Working Group may wish to consider the following example. A secured creditor takes a security right in all present and future assets of the grantor and advances credit to the grantor. The secured creditor registers a notice that covers present and future assets. Subsequently, under law other than the secured transactions law, an unsecured creditor of the grantor obtains a judgement or provisional court order entitling the unsecured creditor to a right in the grantor's present and future assets. Still later, the grantor buys and receives delivery of new assets. At that moment, the grantor acquires rights in those assets and the security right in those assets is created and, because of the earlier registration of the notice, the security right is immediately effective against third parties. At the same time, the unsecured creditor obtains a right in those goods because of the previously granted judgement or provisional court order providing for such a right. The current draft of recommendation 86 provides that the unsecured creditor's right has priority over the security right of the secured creditor.

The Working Group may wish to consider whether in such cases the secured creditor should have priority rather than the judgement creditor. This result would seem to further the goals of the Guide in creating greater certainty for the secured creditor with a view to making more credit available at lower cost. The result could be easily accomplished, without extensive redrafting, by adding in the first sentence of recommendation 86 the words "at the same time as or" immediately prior to the words "before the enforcing unsecured creditor".

The Working Group may also wish to consider whether an exception to this recommendation should be introduced for acquisition security rights that are made effective against third parties within the relevant grace period (see recommendation 184). Acquisition security rights that are made effective against third parties during the relevant grace period should not lose to a judgement creditor described in this recommendation whose right in the encumbered asset arose after the creation of the security right but before it was made effective against third parties. If this were not the case, utilizing the grace period would be too risky for acquisition financiers.

In addition, the Working Group may wish to note that the commentary will explain that the priority under recommendation 84 does not extend to credit committed but not extended before the judgement creditor took the necessary steps to acquire rights in the encumbered assets. This approach is based on the assumption that the judgement will be an event of default under the credit facility enabling the secured creditor to cease extending any credit.

The commentary will also explain the implications of this recommendation for certain practices in which the credit facility does not provide for an event of default, such as a commitment consisting of an independent undertaking where the issuer may not revoke the independent undertaking if it does not permit revocation as a result of a judgement against assets securing the grantor's obligation to reimburse the issuer for a payment under the independent undertaking.

Furthermore, the commentary will explain that, if the priority were to be limited to an amount mentioned in the notice registered, the issue might be resolved since the remaining assets of the grantor would be available for the payment of claims of unsecured creditors (see A/CN.9/593, paras. 80-82). The commentary will also give guidance as to the length of the time period referred to in this recommendation.]

Priority of rights of persons adding or preserving value of encumbered assets

87. If law other than this law gives rights equivalent to security rights to a creditor that has added value to goods (e.g. by repairing them) or preserved the value of goods (e.g. by storing or transporting them), such rights are limited to the goods, whose value has been improved or preserved and which are in the possession of that creditor, up to the value so added or preserved, and have priority over pre-existing security rights in the goods.

[*Note to the Working Group: The Working Group may wish to note that limiting the priority given to storage and repair claims over security rights by reference to the extent to which they add to or preserve the value of the encumbered assets may give rise to a difficult and costly evidentiary burden for repairers, storers or transporters. The Working Group may wish to consider referring instead to the value (or the reasonable value) of the repair, transport or storage services rendered in respect of the encumbered assets. Alternatively, reference could be made to the reasonable expenses of the repairer, storer or transporter. These formulations would still ensure that the priority of the repairer, storer or transporter is limited to services rendered with respect to the encumbered assets while avoiding difficult questions of proof as to the relative value of the encumbered assets before and after the services are rendered*.]

Priority of a supplier's reclamation claim

88. If law other than this law provides that suppliers of goods have the right to reclaim the goods, the law should provide that the right to reclaim the goods is subordinate to security rights in such goods.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation establishes a commercial law rule designed to accord priority to secured creditors over reclamation claims. Reclamation claims may arise by operation of law upon default or financial insolvency of the grantor. If an insolvency proceeding has commenced, applicable insolvency law will determine the extent to which the secured creditors and the reclamation claimants would be stayed or their rights would otherwise be affected (see recommendations 39-51 of the UNCITRAL Insolvency Guide). However, the priority rule established by this recommendation would be unaffected by the insolvency proceeding as provided in recommendation 179. The commentary will*

also explain, for the benefit of States that do adopt a non-unitary approach, that the reclamation claim does not include retention of title.]

Priority of a security right in insolvency proceedings

[*Note to the Working Group: See recommendation 178 in the insolvency chapter*.]

B. Asset-specific recommendations

Priority of a security right in a receivable[30]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general priority recommendations apply to security rights in receivables as well as to outright transfers of receivables*.]

Priority of a security right in a negotiable instrument[31]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general priority recommendations apply to priority with respect to security rights in negotiable instruments, while recommendations 89 and 90 deal with additional priority conflicts*.]

89. The law should provide that a security right in a negotiable instrument that is made effective against third parties by possession of the instrument has priority over a security right in a negotiable instrument that is made effective against third parties by any other method.

90. 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 (in a consensual transaction) 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, to preserve the unfettered negotiability of instruments, knowledge of the existence of a security right on the part of a transferee of an instrument does not mean, by itself, that the transferee did not act in good faith*.]

91. […]

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[30] See A/CN.9/611.

[31] For recommendations 90 and 91, see A/CN.9/611/Add.1, recommendations 74 and 74 bis.

Priority of a security right in a right to payment of funds credited to a bank account[32]

92. The law should provide that a security right in a right to payment of funds credited to a bank account, which is made effective against third parties by control, has priority over a competing security right, which 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 were concluded. If the secured creditor is the depositary bank, its security right has priority over 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) other than a security right of a secured creditor that has acquired control by becoming the account holder.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that third-party effectiveness of a security right in a right to payment of funds credited to a bank account may be achieved by either registration or control. If the security right is effective against third parties, it is effective against and has priority over a competing claimant (e.g. an insolvency representative or a later in time secured creditor). The commentary will also explain that control has an added priority benefit in that the secured creditor not only achieves effectiveness against third parties but it also has priority over an earlier secured creditor whose security interest is effective against third parties by a method other than control.*

In addition, the commentary will explain that a security right of the depositary bank always has priority even over a security right with respect to which the depositary bank has earlier entered into a control agreement because: (a) a security right of the depositary bank should have the same priority as its set-off right, which always has priority; (b) if the depositary bank's security right had no priority, the bank would not enter into any control agreement; and (c) a secured creditor could always seek to obtain a subordination agreement from the depositary bank. The commentary will also explain that, depending on the terms of the control agreement, the depositary bank may have a contractual obligation to a secured creditor with a control agreement even though the secured creditor might not have priority.

The Working Group may wish to recall that, at its tenth session, it had agreed that tracing of funds credited to a bank account would be discussed together with the issue of tracing of proceeds (see A/CN.9/603, para. 67). The Working Group may wish to deal with that issue as an issue of priority. The commentary to this recommendation will make clear that, if a secured creditor has control of a right to payment of funds credited to a bank account, its security right has priority over a security right in cash proceeds of an encumbered asset of another secured creditor that are credited to the same bank account, even if the other secured creditor is able to trace proceeds to the bank account. This is the case even if the competing security right became effective against third parties earlier than the security right held by the secured creditor with control.]

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[32] For recommendations 93-95, see A/CN.9/611/Add.1, recommendations 76-78.

93. The law should provide that any right of the 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 over the security right of any secured creditor other than a secured creditor that has acquired control by becoming the account holder.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendations 92 and 93 mean that third parties are taken to know that they cannot rely on a right to payment of funds credited to a bank account as a primary source of security for extensions of credit and can do so only by obtaining a subordination agreement from the depositary bank or having the account entered in their own name. Consequently, the absence of publicity of the security right is not seen as problematic. The commentary will also explain that, unlike recommendation 120, subparagraph (b), recommendation 93 deals with priority conflicts between rights of set-off of the depositary bank and security rights of other persons. In addition, the commentary will explain that recommendation 93 does not create any rights of set-off, a matter that remains subject to other law. Moreover, the commentary will explain that the exception in recommendation 93 refers to a secured creditor that acquired control by becoming the sole account holder. Where the secured creditor would be just a joint account holder, the grantor will still be able to dispose of the funds credited to the account and thus the secured creditor would not have control (see definition (hh), "control"*.]

94. In the case of a transfer of funds from a bank account initiated by the grantor, the law should provide that 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 lessen the rights of transferees of funds from bank accounts under law other than this law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general priority recommendations apply to security rights in rights to payment of funds credited to a bank account subject to recommendations 120 and 121. The commentary will also explain that the test in recommendation 83, subparagraph (a) (see definition (uu), "buyer in the ordinary course of business"), and in recommendations 93 and 94 essentially the same (i.e. whether the buyer or transferee had knowledge that the sale or transfer violates the rights of the secured creditor under the security agreement). The commentary will also explain that the term "transfer of funds" is intended to cover a variety of transfers, including by cheque and electronic means of communication (see A/61/17, para. 38)*.]

Priority of a security right in money

95. 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, whether the money constitutes an original encumbered asset or proceeds, unless that person has knowledge that the transfer violates the rights of the secured creditor under the security agreement. This recommendation does not lessen the rights of holders of money under law other than this law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation is designed to promote the important policy of maximizing the negotiability of money, limiting negotiability only to the extent necessary to protect the holder of a security right in the money against collusion by a transferee of money and its transferor. It is intended that this recommendation be consistent with recommendation 94 dealing with security rights in funds transferred from a bank account.*

The Working Group may also wish to note that the commentary will clarify that the term "money" in the Guide is intended to refer to, and only to, legal tender, that is, the currency currently in use as a medium of exchange authorized by a Government. Other forms of property are casually spoken of as money, but they are not money for purposes of the Guide. For example, if one deposits currency into one's bank account, reference is often made to money in the bank (or cash in the bank), but the depositor's asset is no longer money, it is instead, under the Guide, "funds credited to a bank account". And the claim of the depositor against the bank is referred to in the Guide as the "right to payment of funds credited to a bank account". Similarly, the deposit of a cheque would result in the depositor's asset no longer being a negotiable instrument, but instead would be funds credited to a bank account. In addition, money held by a coin dealer as part of a collection is not "money" under the Guide.

The Guide addresses security rights in money both as original encumbered assets and as proceeds of another form of encumbered asset. An example of the latter case would be the receipt, by a seller that has granted a security right in its receivables, of payment of its outstanding invoices in currency (not by cheque or electronic funds transfer). Under the Guide, the money in the seller's hands would be the proceeds of the seller's receivable and the secured creditor would have a security right in the money as proceeds. Similarly, if a person that has granted a security right in an item of equipment sells it to a person who pays for it in cash, the money in the seller's hands constitutes proceeds of the equipment and is subject to the security right.

Like money, funds credited to a bank account may be the subject of security rights either as original encumbered assets or as proceeds. If the currency and the cheques were subject to a security right in favour of the depositor's creditor, the funds credited to the bank account would in both cases be the proceeds of the pre-existing encumbered asset (the money or the negotiable instrument). If the credit to the depositor's bank account results from an electronic funds transfer from a third party in payment of a receivable owed by the transmitter to the depositor, the funds credited to the bank account would be the proceeds of the pre-existing encumbered asset (the receivable).

Each provision of the Guide (e.g. rules for creation, effectiveness against third parties, priority and so on) applies to all encumbered assets, except to the extent a special rule is provided for a particular type of asset. Thus, it is always necessary to ascertain whether a special rule exists with respect to money or the right to payment of funds credited to a bank account.

An important example of a special rule is that which governs the rights of a transferee of: (a) money that, in the hands of a transferor, was subject to a security right; and (b) funds that were transferred from a bank account in which those funds,

while owned by the transferor and credited to that bank account, were subject to a security right. Because of the need to preserve the negotiability of money and funds transferred from bank accounts, special rules are provided in the Guide to protect transferees of such assets.

With respect to money and funds credited to a bank account, it is important to focus on whether the issue under consideration concerns: (a) those two assets as property of the grantor; or (b) the rights of third-party transferees from the grantor of money or of funds transferred from the grantor's bank account. The preceding paragraph, which deals with the rule that governs the rights of transferees (the second category), illustrates this distinction. It is separate from the rule (the first category) that governs a priority contest between a security right in money or in funds credited to a bank account vis-à-vis a competing claimant when the grantor still owns (i.e. has not transferred) the encumbered asset.]

Priority of a security right in proceeds under an independent undertaking[33]

96. The law should provide that a security right in proceeds under an independent undertaking, which has been made effective against third parties by control has, with respect to a particular guarantor/issuer, confirmer or nominated person giving value under an independent undertaking, priority over the rights of all other secured creditors that have, with respect to that person, made their security right effective against third parties by a method other than control. 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 secured creditors is determined according to the order in which the acknowledgements were given.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, as the typical method of achieving control is by obtaining an acknowledgment, in the case of several potential payors (e.g. the guarantor/issuer, confirmer and several nominated persons), control is achieved only vis-à-vis the particular guarantor/issuer(s), confirmer(s) or nominated person(s) who gave the acknowledgment(s). Thus, the priority rule must focus on the particular person that is the payor. The basic priority rule makes clear that a secured creditor that has control of the right to proceeds under an independent undertaking has priority over a secured creditor whose security right became effective against third parties automatically. The commentary will also explain that a guarantor/issuer, confirmer or nominated person may, without regard to priority, have a contractual right or obligation to pay an acknowledged secured creditor*.]

Priority of a security right in a negotiable document[34]

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that the general priority recommendations apply to security rights in negotiable documents, while recommendations 97 and 98 deal with additional priority conflicts*.]

97. The law should provide that a security right in goods covered by a negotiable document, which is made effective against third parties by making the security right

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[33] See A/CN.9/611/Add.1, recommendation 62.

[34] For recommendations 97 and 98, see A/CN.9/611/Add.1, recommendations 80 and 81.

in the negotiable document effective against third parties, has priority over a security right in the goods, which is otherwise made effective against third parties while the goods are covered by the document.

98. The law should provide that a security right in a negotiable document and the goods covered thereby is subject to the rights under the law governing negotiable documents of a person to which the negotiable document has been duly negotiated.

Priority of a security right in attachments to immovable property[35]

99. The law should provide that a security right or any other right (such as the right of a buyer or lessor) in attachments to immovable property, which is created and made effective against third parties under immovable property law, has priority over a security right in those attachments, which is made effective against third parties by one of the methods referred to in recommendation 33 or 35.

100. The law should provide that a security right in tangibles that are attachments to immovable property at the time the security right is made effective against third parties or that become attachments to immovable property subsequently, which is made effective against third parties by registration in the immovable property registry under recommendation 52, has priority over a security right or any other right (such as the right of a buyer or lessor) in the related immovable, which is registered subsequently.

[*Note to the Working Group: The Working Group may wish to consider recommendations 99 and 100 together with the relevant recommendation in the chapter on acquisition financing devices (see recommendation 189). The commentary will explain that the words "any other right" refers to any right registrable under immovable property law*.]

Priority of a security right in attachments to movable property subject to a specialized registration or title certificate system[36]

101. The law should provide that a security right or other right (such as the right of a buyer or lessor) in attachments to movable property, which is made effective against third parties under law other than this law by registration in a specialized registry [or by notation on a title certificate], has priority over a security right in those attachments, which is made effective against third parties by one of the methods referred to in recommendations 33 or 35.

[*Note to the Working Group: The Working Group may wish to note that this recommendation is intended to determine priority between a security right in the attachment registered in the general security rights registry and a security right or other right in the same attachment registered in the specialized registry or noted on a title certificate. As recommendation 79 may be sufficient to address this contest, recommendation 101 may not be necessary*.]

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[35] For recommendations 99 and 100, see A/CN.9/WG.VI/WP.26/Add.4, recommendations 82 and 83.

[36] For recommendations 101 and 102, see A/CN.9/WG.VI/WP.26/Add.4, recommendations 84 and 84 bis.

102. A security right or any other right (such as the right of a buyer or lessor) in attachments to movable property, which is made effective against third parties by registration in a specialized registry or by notation on a title certificate under recommendation 53, has priority over a security right or other right in the related movable property, which is registered subsequently.

[*Note to the Working Group: The Working Group may wish to note that this recommendation is intended to determine priority between a security right or other right in an attachment registered in a specialized registry and a security right or other right in the related movable registered subsequently in the specialized registry. The Working Group may wish to consider whether there is any practical need for this recommendation in view of the absence of specialized registry systems that contemplate separate registration of security rights in an attachment. While aircraft registries do often provide for separate registration of engines they are not considered to become automatically part of the airframe but instead they are financed and registered separately*.]

Priority of a security right in a mass or product[37]

[*Note to the Working Group: The Working Group may wish to note that priority between creditors with security rights in property that is commingled and becomes part of a mass or product and unsecured creditors require no special treatment since the regular priority rules apply once it is determined that the security right continues into the mass or product. There are, however, three types of potential priority contests between creditors each of which has a security right with respect to the resulting mass or product: (a) contests between security rights taken in the same tangibles that ultimately become part of a mass or product (e.g. sugar and sugar); (b) contests involving security rights in different tangibles that ultimately become part of a mass or product (e.g. sugar and flour); and (c) contests involving a security right originally taken in the separate tangibles and a security right in the mass or product (e.g. sugar and cake). In order to deal with all these situations, the relevant recommendation has been reformulated in three parts*.]

103. The law should provide that a security right in the same separate tangibles, which continues in a mass or product and is effective against third parties, has the same priority, as against other security rights granted in the separate tangibles, it had immediately before the tangibles became part of the product or mass.

[*Note to the Working Group: The Working Group may wish to note that the effect of the first sentence of this recommendation is to treat all security rights in tangibles that become commingled as having the same priority vis-à-vis each other as they had in the separate property. The rationale for this suggested rule is that the incorporation of goods into a mass or product should have no bearing on the respective rights of creditors with competing security rights in the separate goods. The Working Group may wish to note that the rule is framed to respect both the general priority rules and to cover the super-priority afforded to creditors who may claim "acquisition security rights". This recommendation is predicated on the assumption stated in recommendation 29 (creation) that a secured creditor may not*

[37] For recommendations 103-105, see A/CN.9/WG.VI/WP.26/Add.4, recommendations 85, 85 bis and 85 ter.

receive an amount greater than the value of the tangible immediately before they became part of the mass or product.]

104. The law should provide that, if more than one security right in separate tangibles continues 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 value of their security rights in the mass or product according to the ratio of the value of the separate tangibles immediately before they became part of the mass or product. If there is more than one other security right, the holders of those other security rights are entitled to share in the remainder of the aggregate value of their security rights in the mass or product in the same ratio. If there is only one other security right, the holder of that other security right is entitled to the remainder of the value of its security right in the mass or product.

[*Note to the Working Group: The Working Group may wish to note that, according to recommendation 104, if the value of the sugar is 2 and the flour 5, while the value of the cake is 6 and the amount of the secured obligation 7, the creditors will receive 2/7 and 5/7 of 6. In any case, if the value of the mass or product is less than the amount of the secured obligations, there will be no value left for unsecured creditors. The secured creditors have the same ranking and the object of the rule is to determine the relative value of their rights*.]

105. The law should provide that a security right in separate tangibles, which continues in a mass or product and is effective against third parties, has priority over a security right granted by the same debtor in the mass or product, if it is an acquisition security right.

[*Note to the Working Group: The Working Group may wish to note that the effect of the first sentence of this recommendation is to apply the general priority rules. Security rights in initial property have priority over all security rights in the mass or product that have been taken so as to cover future property, only if the former are acquisition security rights*.]

VIII. Rights and obligations of the parties[38]

Purpose

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

(a) Providing rules on additional terms for the security agreement;

(b) 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) Providing 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

(d) Encouraging party autonomy.

[38] See A/CN.9/611/Add.2, purpose and recommendations 86-87.

A. General recommendations

Suppletive rules relating to the rights of the secured creditor

106. The law should provide that, unless otherwise agreed:

(a) The secured creditor is entitled to be reimbursed for reasonable expenses incurred for the preservation of encumbered assets in its possession;

(b) The secured creditor is entitled to make reasonable use of the encumbered assets in its possession and to inspect encumbered assets in the possession of the grantor.

Mandatory rules relating to the obligations of the party in possession

107. The law should provide that:

(a) The secured creditor or the grantor in possession of the encumbered assets must take any steps necessary to preserve the encumbered assets;

(b) The secured creditor must return the encumbered assets in its possession or terminate the notice registered upon full payment of the secured obligation and termination of all commitments to extend credit.

B. Asset-specific recommendations

Rights and obligations of the assignor and the assignee[39]

[*Note to the Working Group: The Working Group may wish to note that recommendations 108-111 are based on articles 11-14 of the United Nations Assignment Convention. The commentary will explain that they deal with the rights and obligations of the assignor and the assignee as between them*.]

108. The law should provide that:

(a) The mutual rights and obligations of the assignor and the assignee arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein;

(b) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices they have established between themselves.

Representations of the assignor

109. [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;

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[39] For recommendations 108-111, see A/CN.9/611, recommendations 16 bis-16 quinquiens.

(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.

[*Note to the Working Group: The Working Group may wish to note that the bracketed language in the chapeau of this recommendation is intended to reflect the understanding of the Working Group that this recommendation should not apply to an assignment of a non-contractual receivable (see A/CN.9/603, para. 36; see also notes to definition (p), "receivable", and recommendations 2, subparagraph (a), and 22)*.]

Right to notify the debtor of the receivable

110. 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 114 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

111. 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:

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

A. Rights and obligations of the debtor of the receivable[40]

Protection of the debtor of the receivable

[*Note to the Working Group: The Working Group may wish to note that recommendations 112-118 are based on articles 15-21 of the United Nations Assignment Convention. The commentary will explain that these recommendations deal with the rights and obligations of the debtor of the receivable. The commentary will also explain that, if the debtor of the receivable makes payment in accordance with the recommendations in this part, the debtor of the receivable may obtain a valid discharge, irrespective of whether payment was made to the competing claimant with priority. Which one of several competing claimants will finally obtain the proceeds of the payment by the debtor of the receivable is a matter settled in the priority recommendations of the Guide (see, e.g. recommendation 152)*.]

112. 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;

(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:

(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 debtor of the receivable

113. 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; and

(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.

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[40] For recommendations 112-118, see A/CN.9/611, recommendations 17-23.

Discharge of the debtor of the receivable by payment

114. 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

115. 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 23 or 24, 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, under recommendation 2, paragraph (b), the Guide applies to consumers but does not affect the rights of consumers under consumer-protection law*.]

Agreement not to raise defences or rights of set-off

116. 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 115. 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 117, subparagraph (b).

[*Note to the Working Group: The Working Group may wish to note that this recommendation is based on article 19 of the United Nations Assignment Convention, which refers to a signed writing only for a waiver of defences or its modification. If the Working Group decides not to refer to signature in recommendation 13 but rather to evidence that the grantor intended to grant a security right, it may wish to reconsider the reference to signature in recommendation 116. If reference to signature is retained in recommendation 13, an electronic signature should be sufficient (see note to definition (v), "notification of the assignment", and recommendation 11*.]

Modification of the original contract

117. 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

118. 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation does not affect any liability of the assignor towards the debtor of the receivable for breach of contract*.]

B. Rights and obligations of the obligor under a negotiable instrument[41]

119. The law should provide that a secured creditor's rights in a negotiable instrument as against a person obligated on the negotiable instrument or any other person claiming rights under the law governing negotiable instruments are subject to the law governing negotiable instruments.

C. Rights and obligations of the depositary bank[42]

120. 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) The rights of set-off of the depositary bank 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendations 120 and 121 are supplemented by recommendations 92 and 93 (to the extent that there is a priority conflict between a security right or right of set-off of the depositary bank and a security right of another person), as well as recommendations 165-167 (enforcement of a security right in a right to payment of funds credited to a bank account).*

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[41] See A/CN.9/611/Add.1, recommendation X.

[42] For recommendations 123-124, see A/CN.9/611/Add.1, recommendations V and W.

The commentary will also explain that recommendation 120, subparagraph (b), does not deal with a priority conflict but with the situation where the depositary bank itself has both a right of set-off against and a security right in a right to payment of funds credited to a bank account. In this situation, according to recommendation 120, subparagraph (b), the bank's rights of set-off are not impaired or subsumed into (i.e. they remain distinct from) the bank's security right.]

121. The law should provide that nothing in these recommendations obligates a depositary bank:

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

(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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation does not affect the bank-customer relationship and the rights and obligations arising from other law governing bank accounts (e.g. money-laundering and bank secrecy)*.]

D. Rights and obligations of the guarantor/issuer, confirmer or nominated person of an independent undertaking[43]

122. The law should provide that:

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

(b) The rights of a transferee-beneficiary of an independent undertaking are [not affected by] [superior to] a security right in a right to 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-beneficiary under an independent undertaking are not impaired by reason of any security right it may have in rights to proceeds under the independent undertaking, including any right in proceeds under the independent undertaking resulting from a transfer of drawing rights to a transferee-beneficiary.

[*Note to the Working Group: The Working Group may wish to note that the commentary will make clear that this recommendation is intended to ensure that the rights of holders of independent rights to payment, notably nominated persons that have given value and transferee-beneficiaries to whom a transfer has been effected, are superior to the rights of mere assignees of rights in proceeds under a drawing by the original beneficiary. The commentary will also explain that their independent rights are distinct and are not impaired because of their rights as secured creditors of the original beneficiary (in other terms, their status as protected holders of*

[43] For recommendations 120-122, see A/CN.9/611/Add.1, recommendations 25 bis, ter and quater.

independent rights should not be confused with their incidental status as secured creditors). When a nominated person gives value and obtains reimbursement from the issuer, it does so on the basis of its independent reimbursement rights and not as an acquirer of the rights of the beneficiary.]

123. 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-beneficiary of the independent undertaking or an acknowledged assignee of the proceeds under an independent undertaking.

124. 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[44]

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

X. Default and enforcement[45]

Purpose

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

(a) Clear and simple procedures for the enforcement of security rights after debtor default in a predictable and efficient manner;

(b) Procedures that maximize the realization value of 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;

(c) Expeditious judicial and, subject to appropriate safeguards, non-judicial methods for the secured creditor to realize the value of the encumbered assets.

A. General recommendations

General standard of conduct in the context of enforcement

126. The law should provide that a person must exercise its rights and perform its obligations under the provisions of this law governing default and enforcement in good faith and in a commercially reasonable manner.

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[44] See A/CN.9/611/Add.1, recommendation Z.

[45] See A/CN.9/611/Add.2, recommendations 89-124.

Limitations on party autonomy

127. The law should provide that rights and obligations under recommendation 126 cannot be waived unilaterally or varied by agreement at any time.

128. The law should provide that, subject to recommendation 127, 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 their rights and remedies under the provisions of this law governing default and enforcement, but only after default.

129. The law should provide that, subject to recommendation 127, the secured creditor may waive unilaterally or vary by agreement any of its rights and remedies under the provisions of this law governing default and enforcement at any time.

130. The law should provide that a variation of rights and remedies by agreement does not affect the rights of any person not a party to the agreement. A person challenging an agreement has the burden of showing that it was made prior to default or is inconsistent with recommendation 127.

Liability

131. The law should provide that a person is liable for damages arising from its failure to comply with its obligations under the provisions of this law governing default and enforcement.

[*Note to the Working Group: The Working Group may wish to consider whether a waiver or variation of the liability arising under recommendation 131 should be addressed in recommendation 131 or left to other law*.]

Rights and remedies after default

132. The law should provide that after default the grantor and the secured creditor have the rights and remedies set out in the provisions of this law governing default and enforcement, in the security agreement (except to the extent inconsistent with the provisions of this law) and in any other law.

Secured creditor rights and remedies

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

(a) Obtain possession of a tangible encumbered asset, as provided in recommendations 141 and 142;

(b) Sell or otherwise dispose of, lease or license an encumbered asset, as provided in recommendation 143;

(c) Propose to the grantor that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendations 147-150;

(d) 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 proceeds under an independent undertaking, as provided in recommendations 160-168;

(e) Enforce rights under a negotiable document, as provided in recommendation 169;

(f) Enforce its security right in an attachment to immovable property, as provided in recommendation 170; and

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

Judicial and extrajudicial enforcement

134. The law should provide that after default the secured creditor may exercise its rights and remedies provided in recommendation 133 by applying to a court or other authority. Subject to the general standard of conduct provided in recommendation 126 and the requirements provided in recommendations 141-146 with respect to extrajudicial possession and disposition, the secured creditor may elect to exercise its rights and remedies provided in recommendation 133 without having to apply to a court or other authority.

Grantor rights and remedies

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

(a) Pay in full the secured obligation and obtain a release from the security right of all encumbered assets, as provided in recommendation 139;

(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 governing default and enforcement relating to extrajudicial enforcement, as provided in recommendation 140;

(c) Propose to the secured creditor, or reject the proposal of the secured creditor, that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendations 147-150; and

(d) Exercise any other right or remedy provided in the security agreement (except to the extent inconsistent with the provisions of this law governing default and enforcement) or any other law.

Summary judicial proceedings

136. The law should provide for summary judicial proceedings with respect to the exercise of rights and remedies of the secured creditor, the grantor and any other person that owes performance of the secured obligation or claims to have a right in an encumbered asset.

Cumulative rights and remedies

137. The law should provide that the exercise of a right or remedy does not prevent the exercise of another right or remedy, unless the exercise of a right or remedy has made the exercise of another right or remedy impossible.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that the exercise of one remedy (e.g. repossession and*

disposition of an encumbered asset) may make the exercise of another remedy (e.g. acceptance of an encumbered asset in satisfaction of the secured obligation) impossible.]

Rights and remedies with respect to the secured obligation

138. The law should provide that the exercise of a right or remedy with respect to an encumbered asset does not prevent the exercise of a right or remedy with respect to the obligation secured by that asset, and vice versa.

Release of the encumbered assets after full payment

139. The law should provide that, after default and until the disposition, acceptance or collection of an encumbered asset by the secured creditor, 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 assets) is entitled to pay the secured obligation in full, including interest and the costs of enforcement up to the time of full payment. If all commitments to extend credit have terminated, full payment extinguishes the security right in all encumbered assets and, to the extent provided in law other than this law, subrogates the person making the payment to the rights of the secured creditor.

Court relief

140. 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 of this law governing default and enforcement. Unfounded applications and improper interference with or undue delay of the enforcement process should be discouraged and avoided.

[*Note to the Working Group: The Working Group may wish to consider whether the principle with respect to the right to apply to court for relief by the debtor, grantor or other interested third persons should generally apply to the exercise of all rights and remedies under the recommendations of this chapter and not only with respect to extrajudicial enforcement. The Working Group may wish to consider specifying the safeguards necessary to discourage unfounded applications and improper interference with the enforcement process*.]

Secured creditor's right to take possession of an encumbered asset

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

Alternative A

142. The law should provide that the secured creditor may elect to take possession of the 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

(c) Possession can be taken without the use or threat of force.

Alternative B

142. The law should provide that the secured creditor may elect to take possession of the 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 its intention to pursue extrajudicial enforcement with details as to the time and modalities of enforcement; and

(c) [Possession can be taken without the use or threat of force, or any other illegal act.] [At the time of extrajudicial enforcement the grantor does not object.]

[*Note to the Working Group: The Working Group may wish to note that, while under either alternative the grantor has to consent in the security agreement, the alternatives differ as to the requirements for notices and the safeguards for the grantor*.]

Disposition of encumbered assets

143. The law should provide that after default a secured creditor is entitled to sell or otherwise dispose of, lease or license an encumbered asset. Subject to recommendation 126, a secured creditor that elects to exercise this remedy without applying to a court or other authority may select the method, manner, time, place, and other aspects of the disposition, lease or license.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the purpose and effect of this recommendation is to provide a balance between the interests of both the grantor (and its other creditors) and the secured creditor in enabling flexibility in the methods used to dispose of the encumbered assets in order to obtain an economically effective enforcement, while at the same time protecting the grantor against actions taken by the secured creditor that, in the commercial context, are not reasonable. The commentary will also explain that the secured creditor need not be in possession of the encumbered assets to exercise its rights and remedies under this chapter*.]

Advance notice of extrajudicial disposition

144. The law should provide that after default the secured creditor must give notice of its intention to pursue extrajudicial disposition, lease or licence of an encumbered asset.

145. The law should:

(a) Provide that the notice must be given:

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

(ii) To any person with rights in the encumbered asset that, prior to the sending of the notice by the secured creditor to the grantor, notifies in writing the secured creditor of those rights, and

(iii) To any other secured creditor that, more than […] days before the notice is sent to the grantor, registers a notice of a security right in the encumbered asset under the name of the grantor or that is in possession of the encumbered asset at the time it is seized by the secured creditor;

(b) State the manner in which the notice must be given, its timing and its minimum contents, including whether the notice [to the grantor] 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 139;

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the notice to the grantor is sufficient if it is in the language of the security agreement and, if the security right was made effective against third parties by registration, notice under this recommendation is sufficient if it is in the language of the registry*.]

(d) Address the legal consequences of failure to comply with the recommendations governing the notice; and

[*Note to the Working Group: The Working Group may wish to consider whether subparagraph (d) is necessary. Recommendation 131 deals with the liability of the secured creditor for failure to comply with its obligations under this law. In addition, recommendation 140 entitles the grantor to obtain judicial relief if a secured creditor pursuing extrajudicial enforcement violates its obligations under this law. Moreover, the note to recommendation 158 suggests the inclusion of a new recommendation dealing with the consequences of a failure of the secured creditor to comply with its obligations with regard to the rights acquired by a good faith buyer, lessee or licensee*.]

(e) List circumstances in which the notice need not be given either because the delay associated with requiring advance notice could have a negative effect on the realization value of the encumbered assets (as in the case of perishable tangibles or other assets whose value may decline speedily) or because the encumbered assets are of a type sold on a recognized market and therefore have their value set by that market.

146. The law should provide rules ensuring that the notice referred to in recommendation 144 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 realization value of the encumbered assets.

[*Note to the Working Group: The Working Group may wish to consider whether this recommendation 146 should be more specific or included in the*

commentary. The Working Group may also wish to note that the commentary will explain that these rules should balance the interest of the secured creditor in having the flexibility to dispose of the encumbered asset promptly in order to take advantage of favourable market conditions (an interest that also benefits the grantor and other interested parties) with the interest of the grantor and those other parties in obtaining notice of an extrajudicial disposition sufficiently before the disposition in order to take actions that might further protect their interests (such as locating potential buyers for the encumbered asset or attending a public disposition of the encumbered asset to verify the secured creditor's compliance with its obligations under the provisions of the law governing default and enforcement). The commentary will also explain that the recommendation does not require registration of the notice because the notice meets the policy goals that could be served by registration.]

Acceptance of encumbered assets in satisfaction of the secured obligation

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

148. The law should provide that a secured creditor that proposes that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation must send notice of the proposal, specifying the amount owed as of the date the proposal is sent and the amount of the obligation that is proposed to be satisfied by accepting the encumbered asset:

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

(b) To any person with rights in the encumbered asset that, more than […] days prior to the sending of the proposal by the secured creditor to the grantor, has notified in writing the secured creditor of those rights; and

(c) To any other secured creditor that, more than […] days before the proposal is sent to the grantor, has registered a notice of a security right in the encumbered asset in the name of the grantor [more than […] days before the proposal is sent to the grantor] or that was in possession of the encumbered asset at the time it was seized by the secured creditor.

149. The law should provide that, if any addressee of a proposal under recommendation 148 objects in writing within a short time, such as 20 days, after the proposal is sent, the secured creditor may not proceed with the proposal.

150. The law should provide that, if the grantor makes the proposal referred to in recommendation 147 and the secured creditor accepts it, the secured creditor must proceed as provided in recommendations 148 and 149.

Distribution of proceeds of enforcement

151. 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 152, the enforcing secured creditor must pay

any surplus remaining to any subordinate competing claimant, that, prior to any distribution of the surplus, gave notice of its claim to the enforcing secured creditor, to the extent of that claim. Any balance remaining must be remitted to the grantor.

152. The law should also provide that, in the case of extrajudicial enforcement, 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 priority rules of this law.

153. 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 priority rules of this law.

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation provides that the secured creditor has an unsecured claim for any shortfall remaining after payment of the secured obligation. The commentary will also explain that the secured creditor and the grantor may agree in the context of non-recourse or limited-recourse transactions that the secured creditor has no claim for any shortfall*.]

Right of prior-ranking secured creditor to take over enforcement

155. The law should provide that, where a secured creditor or a judgement creditor has commenced enforcement, a secured creditor whose security right has priority over 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, acceptance or collection of an encumbered asset. The right to take control includes the right to enforce by any method available under this law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the secured creditor with priority has the right to substitute its own enforcement process under this law for judgement enforcement proceedings initiated by a subordinate judgement creditor under other law but does not have the right to continue the enforcement process initiated by the judgement creditor under that other law*.]

Rights acquired through judicial disposition

156. 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

157. The law should provide that, if a secured creditor disposes of an encumbered asset without applying to a court or other authority, a good faith purchaser acquires

the grantor's right in the asset subject to rights that have priority over 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 accepted the asset in total or partial satisfaction of the secured obligation.

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

[*Note to the Working Group: The Working Group may wish to consider whether a new recommendation should be included in this chapter along the following lines: "The law should provide that failure of the secured creditor to comply with any of its obligations under the provisions of the law on default and enforcement does not affect the rights of a good faith buyer, lessee or licensee of the encumbered asset."*]

Intersection of movable and immovable property enforcement regimes

159. The law should provide that:

(a) The secured creditor may elect to enforce a security right in attachments to immovable property in accordance with this law 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 this law 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that 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 so as to protect security rights and to ensure the same priority status of security rights as under the law*.]

B. Asset-specific recommendations

Application of the chapter on enforcement to outright transfers of receivables[46]

160. The law should provide that the provisions of the law on default and enforcement do not apply to an outright transfer of receivables with the exception of:

[46] See A/CN.9/611, recommendation 88.

(a) Recommendation 126 in the case of an outright transfer with recourse; and

(b) Recommendations 161 and 162.

Enforcement of a security right in a receivable[47]

161. The law should provide that, in the case of an outright transfer of a receivable, the assignee has the right to collect or otherwise enforce the receivable. In the case of a transfer of a receivable by way of security, the assignee is entitled, subject to recommendations 112 to 118, to collect or otherwise enforce the receivable after default, or before default with the agreement of the assignor.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the secured creditor may, as an alternative to collection, elect to sell a receivable pursuant to recommendations 133, subparagraph (d), and 143. The commentary will also explain that a notification and a payment instruction sent in breach of an agreement between the assignee and the assignor not to notify the debtor of the receivable obligates the debtor of the receivable to pay the assignee but the assignee may be liable to the assignor for breach of contract (see recommendation 110, subparagraph (b))*.]

162. 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 (such as a guarantee or security right).

[*Note to the Working Group: The Working Group may wish to note that the commentary will discuss how other recommendations of the chapter on enforcement may apply to the enforcement of a right securing payment of an assigned receivable*.]

Enforcement of a security right in a negotiable instrument[48]

163. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 119, to collect or otherwise enforce a negotiable instrument that is an encumbered asset against a person obligated on that instrument.

[*Note to the Working Group: The Working Group may wish to note that commentary will explain that as between the secured creditor and the person obligated on the negotiable instrument or other persons claiming rights under the law governing negotiable instruments, the enforcement rights of the secured creditor are subject to the law governing negotiable instruments. The commentary will also include the following examples of such persons:*

(a) The person obligated on the negotiable instrument may be obligated to pay only a holder or other person entitled to enforce the instrument under the law governing negotiable instruments; and

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[47] For recommendations 161 and 162, see A/CN.9/611, recommendations 102 and 103.

[48] For recommendations 163 and 164, see A/CN.9/611/Add.1, recommendations 104 and 105.

(b) The right of the person obligated on the instrument to raise defences to that obligation is determined by the law governing negotiable instruments.]

164. 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 (such as a guarantee or security right).

Enforcement of a security right in a right to payment of funds credited to a bank account[49]

165. 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 119 and 120, to collect or otherwise enforce its right to payment of the funds.

166. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor that has control is entitled, subject to recommendations 120 and 121, to enforce its security right without having to apply to a court or other authority.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, unlike a secured creditor that has to collect the funds to apply them to the secured obligation according to recommendation 151, a depositary bank as a secured creditor may apply the funds to the secured obligation directly. The commentary will also explain that enforcement of the bank's rights of set-off remains subject to other law*.]

167. The law should provide that a secured creditor that does not have control is entitled, subject to recommendations 120 and 121, to collect or otherwise enforce the security right against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

Enforcement of a security right in proceeds under an independent undertaking[50]

168. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor with a security right in proceeds under an independent undertaking is entitled, subject to recommendations 122 to 124, to collect or otherwise enforce its right in the proceeds under the independent undertaking.

[*Note to the Working Group: The Working Group may wish to note that the commentary will make clear that no separate act of transfer by the grantor is necessary for the secured creditor to enforce a security right in a right to proceeds under an independent undertaking when the security right is created automatically under recommendation 24. The commentary will also explain that any obligations of the guarantor/issuer or nominated person to the secured creditor are governed by recommendations 122 to 124. Furthermore, the commentary will explain that recommendation 168 is not intended to disturb any pre-default arrangements agreed upon between the grantor and the secured creditor by which, prior to the grantor's*

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[49] For recommendations 165-167, see A/CN.9/611/Add.1, recommendations 106 bis, 107 and 108.

[50] See A/CN.9/611/Add.1, recommendation 106.

default, the secured creditor may receive the proceeds under an independent undertaking.]

Enforcement of a security right in a negotiable document[51]

[*Note to the Working Group: The Working Group may wish to note that the commentary will also explain that the general recommendations on enforcement of security rights apply here as well. Recommendation 169 deals with a special issue*.]

169. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 125, to enforce a security right in a negotiable document against the issuer or any other person obligated on the negotiable document.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, under law governing negotiable documents, the issuer may be obligated to deliver the goods only to a holder of the negotiable document covering the goods*.]

Enforcement of a security right in attachments to immovable property[52]

[*Note to the Working Group: The Working Group may wish to consider that the general recommendations apply to the enforcement of a security right in attachments to movable property. As to the enforcement of security rights in attachments to immovable property, the Working Group may wish to consider an additional recommendation along the lines of recommendation 170*.]

170. 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 over competing rights in the immovable property. In the case of such an enforcement, a creditor with a competing right in immovable property that has lower priority ranking is entitled to pay off the obligation secured by a security right 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.

XI. Insolvency[53]

A. UNCITRAL Legislative Guide on Insolvency Law: definitions and recommendations

Definitions[54]

12. (b) "Assets of the debtor":[55] property, rights and interests of the debtor, including rights and interests in property, whether or not in the possession of the

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[51] See A/CN.9/611/Add.1, recommendation 109.

[52] See A/CN.9/WG.VI/WP.26/Add.4, note on the enforcement of a security right in attachments.

[53] See A/CN.9/WG.VI/WP.21/Add.3.

[54] These definitions are taken from the glossary of the *UNCITRAL Legislative Guide on Insolvency Law* ("*the Insolvency Guide*") (Introduction, para. 12).

[55] For the purposes of this chapter, the term "debtor" as used in the recommendations taken from the *Insolvency Guide* should be read as referring to a person who meets the requirements for the

debtor, tangible or intangible, movable or immovable, including the debtor's interests in encumbered assets or in third party-owned assets;

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. (pp) "Security interest": a right in an asset to secure payment or other performance of one or more obligations.

[*Note to the Working Group: The Working Group may wish to note that the insolvency chapter may need to address other terms used in the Insolvency Guide and the Secured Transactions Guide*.]

Recommendations[56]

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.

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commencement of insolvency proceedings (see *Insolvency Guide*, part two, chapter I, section A, paras. 1-11, and recommendation 8). Where the security right at issue (which secures the debtor's obligation) is granted by the debtor, the term "debtor" also refers to the grantor. However, where the security right at issue is granted not by the debtor but by a third party (e.g. on the basis of some contractual arrangement with the debtor), the term "debtor" refers to the third-party grantor, since only in that third-party grantor's insolvency is the secured creditor a secured creditor with a proprietary right in the encumbered assets. In the insolvency of a non-grantor debtor, the creditor is an unsecured creditor with an unsecured claim against the non-grantor debtor.

[56] It should be noted that this chapter includes only the recommendations or parts of recommendations of the *Insolvency Guide* that relate specifically to security rights, with the original numbers from the *Insolvency Guide* (for the recommendations not reproduced in this chapter, see the *Insolvency Guide* available at http://www.uncitral.org). It should also be noted that the final text of the recommendations will include the necessary footnotes from the *Insolvency Guide*.

(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) …

Assets constituting the estate

(35) The insolvency law should specify that the estate should include:

(a) Assets of the debtor, 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

(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 or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings, 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;

(b)-(d) …

Measures applicable on commencement

(46) The insolvency law should specify that, on commencement of insolvency proceedings:

(a) Commencement or continuation of individual actions or proceedings 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;

(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; and

(e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.

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;

(b) In reorganization proceedings, a reorganization plan becomes effective; or

(c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires, 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 assets 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

(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.

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 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.

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.

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.

(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.

(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. 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.

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).

[*Note to the Working Group: The Working Group may wish to note that the commentary will make it clear that rejection of a credit agreement does not terminate the security agreement and does not extinguish the security right*.]

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.

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.

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

(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.

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.

Valuation of secured claims

(179)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.

Priority of claims

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 of the guide on secured transactions

Applicable law in insolvency proceedings

171. The insolvency law should provide that, notwithstanding the commencement of insolvency proceedings, the creation, effectiveness against third parties, priority and enforcement of a security right are governed by the law that would be applicable in the absence of the insolvency proceeding. This recommendation does not affect the application of any insolvency rules, including any rules relating to avoidance, priority or enforcement of security rights.

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify the relationship between this recommendation and recommendations 30 and 31 of the Insolvency Guide. The commentary will also explain that this recommendation refers to insolvency rules without regard to whether they are characterized for any purpose as procedural, substantive, jurisdictional or otherwise*.]

Assets subject to an acquisition security right (unitary approach)

172. The insolvency law should provide that, in the case of insolvency proceedings with respect to the grantor, assets subject to an acquisition security right are treated in the same way as assets subject to security rights generally.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in line with recommendation 178, insolvency law would recognize any special priority granted to acquisition security rights over non-acquisition security rights under secured transactions law (e.g. the priority under recommendations 185 and 186)*.]

Assets subject to an ownership right under a retention-of-title device (non-unitary approach)

Alternative A

172. The insolvency law should provide that, in the case of insolvency proceedings with respect to a buyer, financial lessee or grantor, assets subject to rights under a retention-of-title device are treated in the same way as assets subject to a security right.

Alternative B

172. The insolvency law should provide that, in the case of insolvency proceedings with respect to a buyer, financial lessee or grantor, assets subject to rights under a retention-of-title device are treated as third-party owned assets under the *UNCITRAL Legislative Guide on Insolvency Law*.

Receivables subject to an outright transfer before commencement

173. The insolvency law should provide that, if the debtor makes an outright transfer of a receivable before the commencement of the debtor's insolvency proceedings, the receivable is treated in the same way that the insolvency law would treat an asset that has been the subject of an outright transfer by the debtor before commencement. Like a pre-commencement transfer by the debtor of any other asset, the outright transfer of the receivable would be subject to any relevant avoidance rules of the insolvency law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the Guide brings an outright transfer of a receivable (i.e. a transfer of a receivable not for security) within the scope of the Guide and defines a "security right" to include an outright transfer of a receivable. In referring to an outright transfer, the Guide does not affect the application of any rule under law, other than the insolvency law, by which a transaction may be re-characterized as a transfer for security even though the parties denominated the transaction as an outright transfer. In the event of such a re-characterization, the transfer would not qualify as an outright transfer for purposes of the Guide.*

If a security right granted by the debtor before the commencement of the debtor's insolvency proceeding consists, under law other than the insolvency law, of an outright transfer of a receivable, the insolvency law should treat the outright transfer of the receivable as it would treat a pre-commencement transfer by the debtor of any other asset where the transfer qualifies as an outright transfer under law other than the insolvency law. The receivable that is the subject of the outright transfer, like any other asset transferred outright by the debtor before the commencement of the insolvency proceeding, should not be included in the insolvency estate of the debtor (see generally Insolvency Guide recommendation 35, subparagraph (a)).

However, as with the pre-commencement outright transfer by the debtor of any other asset and, indeed, as with any other pre-commencement transaction, the outright transfer of the receivable is nevertheless subject to the avoidance rules of the insolvency law (see Insolvency Guide recommendation 88). For example, the transfer may be avoided, and the receivable may be brought into the insolvency estate, if: (a) the transfer were not effective against third parties at the time of commencement of the insolvency proceeding; (b) the transfer could be avoided under the avoidance rules of the insolvency law relating to undervalued transactions; or (c) in the event that the transfer occurred on one date but was not made effective against third parties until a later date outside of any grace period and during the suspect transfer period, under the avoidance rules of the insolvency law relating to suspect transfers.

If the receivable is not in the insolvency estate and is not brought into the estate under the avoidance rules of the insolvency law, then, because the transferee is the true owner of the receivable, any stay arising under the insolvency law should generally not apply to the collection of the receivable by the transferee and the insolvency law should generally not apply to the receivable or to the transferee's collection of the receivable. Nevertheless, if, pursuant to a contract in effect at the time of the commencement of the insolvency proceeding, the debtor has been engaged by the transferee to collect the receivable for the benefit of the transferee,

any stay under the insolvency law that is applicable with respect to contracts with the debtor generally (and thus applicable to that engagement contract) would, on that basis and notwithstanding the transferee's ownership of the receivable, prevent the transferee from collecting the receivable or otherwise interfering with the engagement contract until the termination of the stay as to the engagement contract or the rejection by the debtor of the engagement contract.]

Assets acquired after commencement

174. Except as provided in recommendation 175, 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 proceeding.

175. 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

176. 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.

Effectiveness of a security right in insolvency proceedings

177. 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.[57]

Priority of a security right in insolvency proceedings

178. The insolvency law should provide that, if a security right is entitled to priority under law other than the insolvency law, the priority continues unimpaired in an insolvency proceeding except if, pursuant to the insolvency law, another claim

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[57] See footnote to recommendation 46, subparagraph (b), of the Insolvency Guide, which provides that:

"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."

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 Legislative Guide on Insolvency Law*.

[*Note to the Working Group: The Working Group may wish to note that commentary will provide examples of exceptions, such as post-commencement priority financing and privileged claims*.]

Effect of a subordination agreement in insolvency proceedings

179. 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.

[*Note to the Working Group: The Working Group may wish to note that recommendation 75 sets forth the general rule on subordination applicable in the absence of insolvency proceedings. The Working Group may wish to consider that: "The general principle in insolvency of recognizing pre-commencement priorities should be interpreted to include priorities based upon a subordination agreement, provided that the agreement is not to provide a ranking higher than would otherwise be accorded to the particular creditor under the applicable law." (see Insolvency Guide, V , B, 1, para. 59, page 268)*.]

Costs and expenses of maintaining value of the encumbered asset in insolvency proceedings

180. 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 (including overhead as appropriate) 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

181. 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.

[*Note to the Working Group: The Working Group may wish to note that the commentary will note that the Insolvency Guide commentary provides the same rule for all assets (see para. 66, part two, chapter II, section B). The commentary on this chapter will make clear that, under recommendation 152 (b) of the Insolvency Guide, creditors in a reorganization proceeding will receive at least as much as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment*.]

XII. Acquisition financing devices[58]

A. Unitary approach to acquisition financing devices

Purpose

The purpose of the provisions of the law on acquisition financing devices is:

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

(b) To provide for equal treatment of all providers of acquisition financing, by applying to them the general regime governing security rights; and

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that subparagraph (c) has been added in the purpose section of this Chapter since the lack of transparency with respect to acquisition financing in those jurisdictions where acquisition financing devices are not subject to a registration requirement is often a serious impediment to non-acquisition inventory and equipment financing (as well as receivables financing in jurisdictions that recognize extended retention-of-title arrangements). Creating transparency would significantly encourage these types of financing*.]

Equivalence of an acquisition security right to a security right

182. The law should provide that an acquisition security right is a security right. Thus, the provisions of the law governing a security right generally, as supplemented by the specific provisions of the law on acquisition financing devices, should apply equally to all acquisition security rights.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the characterization of an acquisition security right as a security right, which means that the acquisition secured creditor is the secured creditor and the grantor is the owner of the encumbered assets, applies only to the secured financing aspect of the transaction. While the acquisition security right secures the grantor's obligation to pay the balance of the purchase price, the underlying transaction is still a sale or a financial lease. Therefore, the law of sales or leases continues to apply to other aspects of the transaction (such as warranties of title and quality, right to re-sell or sub-lease, taxation, insurance and accounting). The commentary will also explain that, if, for example, a secured creditor under an acquisition financing device sold equipment to a buyer which was defective, the buyer would be able to rely on the terms of the contract including other relevant law to pursue such remedies as may be available to a buyer by that other law, such as rejection of the goods and repudiation of the contract by the buyer*.]

[58] See A/CN.9/WG.VI/WP.24/Add.5.

Creation of an acquisition security right

183. The law should provide that an acquisition security right is created [in the same way as a security right under recommendation 13] [by agreement between the grantor and the secured creditor that need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses].

[*Note to the Working Group: The Working Group may wish to note that recommendation 183 (unitary approach) includes the same alternatives as recommendation 183 (non-unitary approach), so as to implement the equivalence principle. However, if the Working Group decides to retain the creation requirements applicable under the general recommendation 13, recommendation 183 may not be necessary as it would repeat the general rule*.]

Effectiveness of an acquisition security right against third parties

184. Except as otherwise provided in recommendation 185, the law should provide that an acquisition security right becomes effective against third parties by registration of a notice of the right in the general security rights registry in the same manner as provided in the provisions of this law governing third-party effectiveness with respect to security rights in the same kind of encumbered assets. If the notice is registered not later than [specify a short time period, such as 20 or 30 days] days from the time of delivery of the goods to the grantor, the right is effective against third parties whose rights arose between the time the acquisition security right was created and its registration, as well as against third parties whose rights were registered subsequently. If the notice is registered after the expiration of that period, the acquisition security right is effective against third parties from the time the notice is registered.

Exceptions to the requirement of registration with respect to an acquisition security right

185. The law should provide that an acquisition security right in consumer goods becomes effective against third parties upon its creation. This provision does not affect security rights made effective against third parties by possession or by registration in a specialized registry or notation on a title certificate.

Priority of an acquisition security right in goods other than inventory or consumer goods as against an earlier registered non-acquisition security right in the same goods

186. The law should provide that an acquisition security right in goods other than inventory or consumer goods has priority as against a non-acquisition security right in the same goods (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 financier retains possession of the goods; or

(b) Notice of the acquisition security right is registered within a period of [the same number of days specified in recommendation 184] from the delivery of the goods to the grantor.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a common situation in which this priority conflict arises is where a pre-existing secured creditor has a security right in all of the grantor's existing and future-acquired goods and another creditor finances the acquisition of specific goods*.]

Priority of an acquisition security right in inventory as against an earlier registered non-acquisition security right in inventory of the same kind

187. The law should provide that an acquisition security right in inventory of the grantor has priority as against a non-acquisition security right in the grantor's inventory of the same kind (even if that security right became effective against third parties before the acquisition security right became effective against third parties), provided that:

(a) The acquisition financier retains possession of the goods; or

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

(i) A notice of the acquisition security right is registered in the general security rights registry; and

(ii) The holder of the earlier registered security right is notified in writing by the acquisition financier that the acquisition financier intends to enter into one or more acquisition financing transactions with respect to the inventory described in the notification. The notification should describe the inventory sufficiently to inform the holder of the earlier-registered security right of the inventory being financed.

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

188. The law should provide that, notwithstanding recommendation 86, an acquisition security right that is made effective against third parties within the grace period provided in recommendation 184 has priority as against the rights of an unsecured creditor that, under law other than this law:

(a) Obtained a judgement or provisional court order against a grantor after the creation of the acquisition security right; and

(b) Took the steps necessary to acquire rights in encumbered assets of the grantor by reason of the judgement or provisional court order.

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

189. The law should provide that an acquisition security right in tangibles that are to become attachments to immovable property, registered in the immovable property registry within [specify a short time period, such as 20-30 days] days after the tangibles become attachments, has priority as against an existing encumbrance in the related immovable property (other than an encumbrance securing a loan financing the construction of the immovable property).

One or more acquisition financing transactions

190. The law should provide that a single notification to holders of earlier registered non-acquisition security rights may cover encumbered assets acquired through one or more acquisition financing transactions between the same parties, without those transactions having to be identified in the notification. However, the notification should be effective only for acquisition security rights in encumbered assets delivered within a period of [specify time, such as five years] years after the notification is given.

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

191. The law should provide that the priority, provided under recommendation 186 (unitary approach), for an acquisition security right in goods other than inventory or consumer goods as against an earlier registered non-acquisition security right in the same goods extends to the proceeds of such goods.

Priority of an acquisition security right in proceeds of inventory

192. The law should provide that the priority, provided under recommendation 187 (unitary approach), for an acquisition security right in inventory as against an earlier registered security right in inventory of the same kind extends to the proceeds of such inventory [other than receivables]. However, the acquisition financier must notify earlier registered financiers with a security right in assets of the same kind as the proceeds before delivery of the inventory to the grantor or, at the latest, at the time the proceeds arise.

[*Note to the Working Group: The Working Group may wish to reconsider the question whether the priority of recommendation 192 should be extended to proceeds consisting of receivables. The extension of the priority to receivables would significantly discourage receivables financing. In most instances, there may be no practical way for a receivables financier to determine which of the grantor's receivables would be subject to the acquisition financier's paramount security right. The result might be that the receivables financier may simply stop financing when it receives the notice contemplated by this recommendation. This possibility will either discourage receivables financing or, if the receivables financier agrees to continue financing only if there are no inventory acquisition financing devices, it will discourage acquisition financing. Neither possibility is consistent with the objectives of the Guide. A better solution would be for the priority of the inventory financier not to extend to proceeds consisting of receivables so that the receivables financier is encouraged to provide credit against the receivables and the proceeds of that credit may be used by the grantor to pay the inventory financier. The Working Group may wish to note that, in most jurisdictions that recognize retention-of-title arrangements, the property right of the retention-of-title seller in the inventory sold does not extend to receivables arising from the sale of that inventory*.]

Enforcement of an acquisition security right

193. The law should provide that the provisions of the law on default and enforcement apply to the enforcement of an acquisition security right.

[*Note to the Working Group: The Working Group may also wish to consider additional text along the following lines:*

"In the case of an ownership right under a retention-of-title device, if notice of the right is required to be registered in the security rights registry, but is not registered, or is registered only after the expiration of the time specified in recommendation 184, the retention-of-title seller, financial lessor or purchase money lender is entitled to repossess the goods only if they are still in the possession of the buyer, financial lessee or grantor and takes the goods back subject to any security rights granted by the buyer, financial lessee or grantor. However, in the case of a late registration, if the notice is registered before the sale of the goods by the original buyer, financial lessee or grantor, the seller, financial lessor or purchase-money lender may repossess the goods in the possession of the subsequent buyer, other than [a buyer of inventory in the ordinary course of business of the seller and any other person whose rights to the inventory derive from that buyer (even if such buyer or other person has knowledge of the existence of the security right)] [a good faith buyer]".]

Acquisition security rights in insolvency proceedings

[*Note to the Working Group: The Working Group may wish to note that the recommendations that deal with acquisition financing devices in insolvency proceedings are contained in the insolvency chapter*.]

Applicable law to an acquisition security right

194. The law should provide that the provisions of this law on conflict of laws apply to acquisition security rights.

B. Non-unitary approach to acquisition financing devices

[*Note to the Working Group: The Working Group may wish to note that, at its thirty-ninth session, the Commission approved the substance of the unitary approach and referred the non-unitary approach to the Working Group for further discussion (see A/61/17, para. 69)*.]

Purpose (non-unitary approach)

The purpose of the provisions of the law on retention-of-title devices is:

(a) To recognize the importance and facilitate the use of retention-of-title devices as a source of affordable credit, in particular for small- and medium-size businesses;

(b) To provide for equal treatment of all retention-of-title sellers, financial lessors and purchase-money lenders and apply to retention-of-title devices particular rules so as to produce outcomes that are functionally equivalent to the outcomes

produced by a security rights regime [to the extent compatible with the regime governing the enforcement of ownership rights]; and

(c) To facilitate the use of security rights by creating transparency with respect to retention-of-title devices.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a separate set of recommendations has been prepared for States that may wish to adopt a non-unitary approach with respect to retention-of-title devices. In order to use the relevant terminology and to reflect a slight difference in the issue, where necessary, separate titles have been added to the recommendations of the non-unitary approach. In addition, separate (but the same) numbers have been included to the recommendations of the non-unitary approach not only to facilitate their reading but also their possible later reproduction as a separate, consolidated set of recommendations at the end of the recommendations of the unitary approach.*

The Working Group may wish to note that the commentary will explain that the words "to the extent compatible with the regime governing the enforcement of ownership rights" have been added to align the purpose section with recommendations 172, alternative B (non-unitary approach), and 193, alternative B (non-unitary approach), on the enforcement of retention-of-title devices in and outside of insolvency proceedings. Under this alternative of the non-unitary approach, the treatment of the enforcement of acquisition security rights in and outside of insolvency proceedings would not be fully equivalent to the treatment of security rights but would rather conform to the treatment of enforcement of ownership rights (for a discussion of the differences, see A/CN.9/WG.VI/WP.17, paras. 39-42; see also the note to recommendation 193, non-unitary approach, alternative B). The commentary will discuss the consequences of such an approach (e.g. lack of uniformity, potential impact on the availability of credit) to assist States in making a choice.]

Equivalence of an ownership right under a retention-of-title device to a security right

182. If the law excludes ownership rights under retention-of-title devices from the definition of "security right", the law should provide that a purchase-money lender has the same rights as a seller in a retention-of-title transaction. The provisions of this law applicable to security rights, as supplemented by the specific provisions applicable to ownership rights under retention-of-title devices in this chapter, apply to all retention-of-title devices in a manner that preserves the functional equivalence of rights under retention-of-title devices to security rights [to the extent compatible with the relevant ownership regime in the case of enforcement].

[*Note to the Working Group: The Working Group may wish to note that, in order to implement its decision to treat all providers of acquisition financing equally (see A/CN.9/574, para. 35), under the non-unitary approach, language has been added to recommendation 182 (non-unitary approach) to ensure that purchase-money lenders are treated as owners. The commentary will explain the words "to the extent compatible with the relevant ownership regime in the case of enforcement" and their consequences with respect to the enforcement of an*

ownership right under a retention-of-title device in and outside insolvency (see recommendations 172, alternative B (non-unitary approach), and 193, alternative B (non-unitary approach)).]

Creation of an ownership right under a retention-of-title device

183. The law should provide that an ownership right under a retention-of-title device is created [in the same way as a security right under recommendation 13] [by an agreement between the buyer, financial lessee or grantor and the seller, financial lessor or purchase-money lender that need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses].

[*Note to the Working Group: The Working Group may wish to note that, in order to ensure that all issues addressed by recommendation 13 are covered, recommendation 183 (non-unitary approach) refers to creation, although no new ownership right is created by a retention-of-title device. The Working Group may wish to consider alternative wording or an explanation for the commentary.*

Recommendation 183 (non-unitary approach) provides for two alternatives, one based on article 11 of the United Nations Sales Convention ("CISG") and another based on the form requirements foreseen in recommendation 13 of the Guide.

With regard to recommendation 183 (non-unitary approach), the Working Group may wish to consider additional wording along the following lines:

"The law should also provide that a buyer, financial lessee or grantor has the power to grant a security right in the goods sold or leased notwithstanding the seller's, lessor's or purchase-money lender's ownership rights."]

Effectiveness of an ownership right under a retention-of-title device against third parties

184. Except as otherwise provided in recommendation 185, the law should provide that an ownership right under a retention-of-title device becomes effective against third parties by registration of a notice of the right in the general security rights registry in the same manner as provided in the provisions of this law governing third-party effectiveness with respect to security rights in the same kind of encumbered assets. If the notice is registered not later than [specify a short time period, such as 20 or 30 days] days from the time of delivery of the goods to the buyer, financial lessee or grantor, the right is effective against third parties whose rights arose between the time the retention of title device was concluded and its registration, as well as against third parties whose rights were registered subsequently. If the notice is registered after the expiration of that period, the ownership right under the retention-of-title device is effective against third parties from the time the notice is registered.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in the case of a retention-of-title device, effectiveness against third parties and priority over competing claimants means that the ownership right of the retention-of-title seller, financial lessor or purchase-money*

lender to the goods may be asserted against third parties, including competing claimants, claiming through the buyer, lessee or grantor.]

Exceptions to the requirement of registration with respect to an ownership right under a retention-of-title device

185. The law should provide that an ownership right under a retention-of-title device relating to consumer goods becomes effective against third parties upon its creation. This provision does not affect rights made effective against third parties by possession or by registration in a specialized registry or notation on a title certificate.

[*Note to the Working Group: The Working Group may wish to consider whether all security rights in consumer goods (perhaps, with the exception of security rights in consumer goods that become attachments to immovable property) should be exempt from the requirement of registration (see note to recommendation 41)*.]

Priority of an ownership right under a retention-of-title device in goods other than inventory or consumer goods as against an earlier registered non-acquisition security right in the same goods

186. The law should provide that an ownership right under a retention-of-title device in goods other than inventory or consumer goods has priority as against a security right in the same goods (even if a notice of that security right was registered in the general security rights registry before registration of a notice of the ownership right under the retention-of-title device), provided that:

(a) The seller, financial lessor or purchase-money lender retains possession of the goods; or

(b) Notice of the ownership right under the retention-of-title device is registered within a period of [the same number of days specified in recommendation 184] from the delivery of the goods to the buyer, financial lessee or grantor.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain the impact of recommendations 186 and 187 in non-unitary systems along the lines described in document A/CN.9/588, paragraph 60. The Working Group may also wish to consider whether subparagraph (a) could apply to a retention-of-title device in view of the fact that normally possession of the goods would be delivered to the buyer, financial lessee or grantor*.]

Priority of an ownership right under a retention-of-title device in inventory as against an earlier registered non-acquisition security right in inventory of the same kind

187. The law should provide that an ownership right under a retention-of-title device in inventory has priority as against a security right in inventory of the same kind (even if that right became effective against third parties before the ownership right under the retention-of-title device became effective against third parties), provided that:

(a) The seller, the financial lessor or the purchase-money lender retains possession of the goods; or

(b) Before delivery of the inventory to the buyer, financial lessee or grantor:

(i) A notice of the ownership right under the retention-of-title device is registered in the general security rights registry; and

(ii) The holder of an earlier registered security right is notified in writing that the seller, financial lessor or purchase-money lender intends to enter into one or more retention-of-title transactions with respect to the inventory. The notification should describe the inventory sufficiently to inform the holder of an earlier registered security right of the inventory being financed.

[*Note to the Working Group: The Working Group may wish to consider whether subparagraph (a) could apply to a retention-of-title transaction or financial lease in view of the fact that normally possession of the goods would be delivered to the buyer, financial lessee or grantor. The Working Group may also wish to consider whether the registry should notify automatically inventory financiers on record (see A/61/17, para. 67). It should be noted that such an approach would require the registry to distinguish inventory financiers from other financiers. In addition, such an approach would require the grantor to ensure that the registry has given such notice before the grantor delivers the inventory to the acquisition financier*.]

Priority of an ownership right under a retention-of-title device over the right of a judgement creditor

188. The law should provide that, notwithstanding recommendation 86, an ownership right under a retention-of-title device that is made effective against third parties within the grace period provided in recommendation 184 has priority as against the rights of an unsecured creditor that, under law other than this law:

(a) Obtained a judgement against a buyer, financial lessee or grantor after the creation of the ownership right under the retention-of-title device; and

(b) Took the steps necessary to acquire rights in the relevant assets of the buyer, financial lessee or grantor by reason of the judgement.

[*Note to the Working Group: The Working Group may wish to consider that an acquisition security right that became effective against third parties during the relevant grace period should not lose to the rights of a judgement creditor described in this recommendation, whose interest in the encumbered asset arose after the creation of the acquisition security right but before it became effective against third parties. If this were not the case, utilizing the grace period would be too risky for acquisition financiers. The Working Group may wish to consider this recommendation together with recommendation 86*.]

Priority of ownership rights under retention-of-title devices with respect to attachments to immovable property as against earlier registered security rights in the immovable property

189. The law should provide that an ownership right under a retention-of-title device in tangibles that are to become attachments to immovable property,

registered in the immovable property registry within [specify a short time period, such as 20-30 days] days after the tangibles become attachments, has priority as against an existing encumbrance in the related immovable property (other than an encumbrance securing a loan financing the construction of the immovable property).]

[*Note to the Working Group: The Working Group may wish to note that the priority introduced by this recommendation would not prejudice the rights of a holder of an existing mortgage on the related immovable property because the mortgagee would normally not rely upon subsequently added attachments. However, the priority created by this rule should not operate to grant priority over construction lenders that are presumed to rely upon all goods that become attachments to immovable property during the course of construction*.]

One or more retention-of-title devices

190. The law should provide that a single notification to holders of earlier registered security rights may cover assets acquired through one or more retention-of-title devices between the same parties, without those devices having to be identified in the notification. However, the notification should be effective only for ownership rights in assets delivered within a period of [specify time, such as five years] years after the notification is given.

Priority of an ownership right under a retention-of-title device in proceeds of goods other than inventory or consumer goods

191. The law should provide that the priority, provided under recommendation 186 (non-unitary approach), for an ownership right under a retention-of-title device in goods other than inventory extends to the proceeds of such goods.

Priority of an ownership right under a retention-of-title device in proceeds of inventory

192. The law should provide that the priority of an ownership right under a retention-of-title device in inventory provided under recommendation 186 (non-unitary approach) extends to the proceeds of such inventory [other than receivables]. However, the retention-of-title seller, financial lessor or purchase-money lender must notify earlier-registered financiers with a security right in assets of the same kind as the proceeds before actual delivery of the inventory to the buyer, financial lessee or grantor, or, at the latest, at the time the proceeds arise.

Enforcement of an ownership right under a retention-of-title device

Alternative A

193. The law should provide that, in the case of default, a retention-of-title device must be enforced in such a manner that:

(a) The same principles and objectives as those governing enforcement of security rights generally are complied with; and

(b) The same results are obtained.

[*Note to the Working Group: The Working Group at its eighth session recommended formulation of the non-unitary approach along the lines set out above*.]

Alternative B

193. The law should provide that the provisions of the law on default and enforcement apply to the enforcement of ownership rights under retention-of-title devices to the extent compatible with the regime applicable to the enforcement of ownership rights.

[*Note to the Working Group: The Working Group may wish to note that the last words of the second alternative under a non-unitary approach would conform the non-unitary approach to the existing law in each State on the enforcement of ownership rights rather than to the enforcement recommendations of the Guide. For example, in some jurisdictions this would mean that, upon default, a seller that retained title and obtained possession of the assets would be permitted to retain, rather than dispose of, the assets and would not have to account to the buyer for any surplus of the value of those assets over the unpaid portion of the purchase price and would not have a claim against the buyer with respect to the unpaid portion of the purchase price (for a discussion of the differences, see A/CN.9/WG.VI/WP.17, paras. 39-42; see also the second alternative of the non-unitary approach recommendation on the enforcement of ownership rights under retention-of-title devices in insolvency proceedings below)*.]

Ownership rights under retention-of-title devices in insolvency proceedings

[*Note to the Working Group: The Working Group may wish to note that the recommendations that deal with acquisition financing devices in insolvency proceedings are contained in the insolvency chapter*.]

Applicable law to an ownership right under a retention-of-title device

194. The law should provide that the provisions of this law on conflict of laws apply to retention-of-title devices.

XIII. Conflict of laws*[59]

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; the pre-default rights and obligations between the secured creditor and the grantor; the effectiveness of a security right against third parties; the priority of a security right as against the rights of competing claimants; and the enforcement of a security right.[60]

These rules are also applicable to:

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

[59] See A/CN.9/WG.VI/WP.24.

[60] The meaning of these terms is elaborated upon in chapters IV, V, VII, VIII and X.

(a) "Security rights" within the scope of the law, which includes rights under retention-of-title sales and financial leases, as well as outright transfers of receivables; and

(b) In States that enact a non-unitary system with respect to acquisition financing devices, the rights of a seller or a financial lessor of goods that retains title to the goods.

A. General recommendations

Law applicable to a security right in tangible property[61]

195. The law should provide that, except as otherwise provided in recommendations 196 and 209, the creation, the effectiveness against third parties and the priority as against the rights of competing claimants of a security right in tangible property are governed by the law of the State in which the encumbered asset is located. However, with respect to security rights in tangible property of a type ordinarily used in more than one State, the law should provide that such issues are governed by the law of the State in which the grantor is located. [With respect to security rights in the type of tangible property mentioned in the preceding sentence that is subject to a title registration system, the law should provide that such issues are governed by the law of the State under the authority of which the registry is maintained.]

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the application of recommendation 195 to negotiable instruments and rights to payment of funds credited to a bank account is subject to the limited exception provided in recommendation 209 that the law of the grantor's location determines in specified circumstances whether the effectiveness against third parties has been achieved by registration. The commentary will also explain that recommendation 196 provides an additional option for the creation and third-party effectiveness of security rights in goods in transit and export goods.*

The Working Group may wish to note that the commentary will explain that "tangible property of a type ordinarily used in more than one State" refers to mobile goods, such as motor vehicles. The same term in the bracketed sentence in recommendation 195 refers to mobile goods, such as ships and aircraft.

In addition, the Working Group may wish to consider whether a rule along the lines of recommendation 209 should apply to security rights in tangible assets covered in recommendation 195. If that approach were to be followed, if the grantor's location provided for third-party effectiveness by registration, the only law applicable to third-party effectiveness of security rights in tangible assets other than by possession would be the law of the grantor's location and not the law of the location of the assets.

The Working Group may wish to note that a security right may be created in goods either pursuant to recommendation 12 or by the creation of a security right in a negotiable document representing those goods pursuant to recommendation 27. In either case, recommendation 195 provides that the creation, third-party

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[61] See A/CN.9/611/Add.1, recommendation 136.

effectiveness and priority of the security right are governed by the law of State of the location of the goods or document, as applicable. Because goods in transit and export goods, by their nature, move from State to State and, therefore, the location of the goods at any particular moment might be fortuitous and temporary, recommendation 196 provides an alternative method for creation and third-party effectiveness of a security right in such goods referring to the law of the State of the ultimate destination of the goods, provided that the goods reach that destination within a reasonable period of time. Recommendation 196 thus addresses the problems that could result from unwavering adherence to the "location of the tangible asset rule" in the context of goods whose location will certainly change as a result of the very nature of the financing transaction.

The Working Group may also wish to note that, in many financing transactions involving negotiable documents, the location of the negotiable document may change, as, for example, where a bill of lading is sent from the consignor to the consignee or the secured creditor. In such transactions, at any particular time the negotiable document might be located in a different State than the goods that it represents, even though the goods and the negotiable document will ultimately be located in the same State. In order to address the question of the law applicable to security rights in goods covered by a negotiable document, at the tenth session of the Working Group the suggestion was made that the practical issue with respect to the goods that is addressed by recommendation 196 might also be present for the negotiable document representing those goods and that, accordingly, there may be some advantage in broadening the rule in recommendation 196 to cover negotiable documents (see A/CN.9/603, para. 60).

Thus, the Working Group may wish to consider extending the application of recommendation 196 to negotiable documents. In that connection, the Working Group may wish to take into consideration that, under recommendations 97 and 98, the priority of a security right in goods covered by a negotiable document is always subject to the law of the location of the document. If the applicable law is the law of a State that has enacted the recommendations of the Guide, under recommendation 195, the security right in the goods that became effective against third parties as a result of the security right in the negotiable document becoming effective against third parties will have priority over a security right in the goods that became effective against third parties by another method. The Working Group may also wish to note that, under recommendation 200, the enforcement of the security right in the goods or the document is always subject to the law of the State where enforcement takes place or the law governing the security agreement, depending on which alternative is retained (for this note, see A/CN.9/611/Add.1, note to recommendation 136).]

Law applicable to a security right in goods in transit and export goods

196. The law should provide that a security right in tangible property (other than negotiable instruments or negotiable documents) 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 also be created 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 short time period of [to be specified] days after the time of creation of the security right.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that a security right in goods in transit and export goods can be created and made effective against third parties, under recommendation 195, in accordance with the law of the State of their location at the time of creation or, under recommendation 196, in accordance with the law of the State of their ultimate destination. The commentary will also explain that the law of the State of the ultimate destination that governs creation and third-party effectiveness will apply even in the case of a contest with competing rights that were created and made effective against third parties while the export goods were located in the State of origin.*

In addition, the commentary will explain that the rule in this recommendation: (a) is applicable to encumbered assets that travel whether or not negotiable documents relating to the goods accompany the goods; (b) is not applicable to encumbered goods that do not travel, whether or not negotiable documents relating to the goods do travel; and (c) is not applicable to encumbered negotiable documents whether or not they travel (for this note, see A/CN.9/611/Add.1, note to recommendation 142).]

Law applicable to a security right in intangible property[62]

197. The law should provide that the creation, the effectiveness against third parties and the priority as against 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. [However, with respect to security rights in intangible property that is subject to a title registration system, the law should provide that such issues are governed by the law of the State in which […].]

[*Note to the Working Group: The commentary will explain that this recommendation, reflecting the principle in articles 22 and 30 of the United Nations Assignment Convention, applies, for example, to receivables. The second sentence within square brackets is intended to draw the attention of the Working Group to the possibility that a different law might apply to other intangible assets that are subject to title registration, such as intellectual property rights (e.g. the lex loci protectionis for patents and trademarks and the lex loci protectionis or the lex originis for copyrights)*.]

Law applicable to a security right in proceeds

198. The law should provide that:

(a) The creation of a security right in proceeds is governed by the law [of the State whose law governs] [governing] the creation of the security right in the original encumbered asset from which the proceeds arose; and

(b) The effectiveness against third parties and the priority as against the rights of competing claimants of a security right in proceeds are governed by the same law as the law [of the State whose law governs] [governing] the effectiveness against third parties and the priority over the rights of competing claimants of a security right in original encumbered assets of the same kind as the proceeds.

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[62] See A/CN.9/611/Add.1, recommendation 137.

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

199. The law should provide that the mutual rights and obligations of the grantor and the secured creditor with respect to the security right, whether arising from the security agreement or by law, are governed by 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 enforcement of a security right

200. Except as provided in the provisions of this law on the law applicable to the enforcement of a security right after commencement of an insolvency proceeding with respect to the grantor, the law should provide that matters affecting the enforcement of a security right are governed by

Alternative A

the law of the State where enforcement takes place.

Alternative B

the law governing the security agreement. However, possession of an encumbered asset without the consent of the person in possession may be taken by the secured creditor only in accordance with the law of the State in which that asset is located at the time the secured creditor takes possession.

[*Note to the Working Group: The Working Group may also wish to note that, at its thirty-ninth session, the Commission urged the Working Group to reach agreement, if at all possible, on one of the alternatives set out in recommendations 200 and 208*.]

201. The enforcement of a security right in an attachment to immovable property is governed by the law of the State where the immovable property is located.

[*Note to the Working Group: The Working Group may wish to consider that recommendation 195 is sufficient with respect to the law applicable to the creation, third-party effectiveness and priority of a security right in an attachment to movable property, while recommendation 200 is sufficient for the enforcement of such a security right (for this note, see A/CN.9/WG.VI/WP.26/Add.4, note on the law applicable to the enforcement of a security right in attachments)*.]

Impact of insolvency on the law applicable

[*Note to the Working Group: The Working Group may wish to note that the recommendations on the law applicable to the enforcement of a security right in an insolvency proceeding are contained in the chapter on insolvency (see recommendation 171)*.]

Meaning of "location" of the grantor

202. The law should provide that, for the purposes of the provisions of this law on conflict of laws, 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 when determining location

203. 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 provisions of this law on conflict of laws refer, 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;

(b) If all rights of competing claimants in an encumbered asset arose before a change in location of the asset or the grantor, references in the provisions of this law on conflict of laws to the location of the asset or of the grantor (as relevant under the recommendations in this chapter) refer, with respect to third-party effectiveness and priority issues, to the location prior to the change in location.

Continued third-party effectiveness of a security right upon change of location

204. The law should provide that, if a security right in encumbered assets is effective against third parties under the law of the State in which the encumbered assets or the grantor (as relevant under the provisions of the law on conflict of laws) are located and that location changes to this State (i.e. the State that has enacted the law), the security right continues to be effective against third parties under the law of this State for a period of [to be specified] days after the location of the encumbered assets or the grantor (as relevant under the provisions of the law on conflict of laws) has changed to this State. 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 at which that event occurred under the law of the State in which the encumbered assets or the grantor were located before their location changed to this State.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the application of this recommendation is not based on reciprocity, that is, it operates regardless of whether or not the State of the old location of the encumbered assets or of the grantor has enacted an equivalent provision to cover the converse situation involving the relocation of encumbered assets or a grantor to that State. The commentary will also explain that this recommendation will apply if the asset or the grantor moves from an enacting State or a non-enacting State to an enacting State. This recommendation (or the Guide) will not apply if the asset or the grantor moves from an enacting State or a non-enacting State to a non-enacting State. Furthermore, the commentary will explain that the effect of the last sentence of this recommendation is that priority in the receiving State "relates back" to the time at which the relevant event for achieving third-party effectiveness occurred in the other State*.]

Exclusion of renvoi

205. The law should provide that the reference in the provisions of the law on conflict of laws 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.

Public policy and internationally mandatory rules

206. The law should provide that:

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

(b) A forum may apply those provisions of its own law which, irrespective of rules of conflict of laws, must be applied even to international situations; and

(c) The rules in subparagraphs (a) and (b) of this recommendation do not permit the application of provisions of the law of the forum to third-party effectiveness or priority among competing claimants, unless the law of the forum is the applicable law under the provisions of this law on conflict of laws.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain the meaning of public policy and internationally mandatory rules referred to in this recommendation. Subparagraphs (a) and (b), which track the language of article 11, paragraphs 1 and 2, of the Hague Securities Convention, have been prepared pursuant to a suggestion made at the eighth session of the Working Group (see A/CN.9/588, para. 107). Subparagraph (c), which tracks the language of article 11, paragraph 3, of the Hague Securities Convention, is also in line with articles 30 to 32 of the United Nations Assignment Convention. It is intended to ensure that the certainty of the law applicable to third-party effectiveness and priority of a security right achieved with the recommendations in this chapter will not be compromised by application of the law of the forum*.]

B. Asset-specific recommendations

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

207. The law should provide that the law of the State in which the assignor is located governs 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 over the rights of competing claimants. However, a priority conflict involving the rights of a competing third party registered in the immovable property registry of the State in which the immovable property is located is governed by the law of that State.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation is designed to address the law applicable to assignments of receivables owing to the grantor under an agreement for the sale or lease of an immovable or under a security agreement over an immovable. In a number of States, it is not possible to create rights in such receivables independently of the related immovable, with the result that the*

effectiveness as between the parties, the third-party effectiveness and the priority of a security right in the receivables are governed by the law (and, in particular, the registry regime) that applies to the related immovable. In other States, it is possible to grant a security right in such receivables independently of the related immovable, but the secured creditor is subordinated to third-party rights that are registered against the related immovable in the immovable property registry.

The second sentence of this recommendation is designed to preserve the application of the law of the State where the related immovable is located in order to protect third parties that rely on the registration in the immovable property registry of that State. Reference is made to rights of a competing third party as the term "competing claimant" is defined by reference to security rights in movables. Reference is also made to "rights" of such parties, since rights of third parties could include not just competing mortgagees but also assignees or buyers of the immovable or the related intangible and indeed any class of third-party right for which the immovable property regime makes provision for registration. In addition, reference is made to a right "registered in the immovable property registry" rather than "that became effective against third parties by registration", since: (a) some immovable property registries do not distinguish between inter-parties and third party effectiveness; and (b) immovable property registries do not necessarily require registration for general third-party effectiveness but only for effectiveness against third parties whose rights are also registrable in the immovable property registry (e.g. registration may not be needed for effectiveness against an insolvency administrator or a judgement creditor.]

Law applicable to a security right in a right to payment of funds credited to a bank account[63]

208. Except as otherwise provided in recommendation 209, the law should provide that the creation, the effectiveness against third parties, the priority as against the rights of competing claimants, the rights and duties of the depositary bank with respect to the security right and the enforcement of the security right in a right to payment of funds credited to a bank account are governed by

Alternative A

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 fallback rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

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[63] See A/CN.9/611/Add.1, recommendation 139.

[*Note to the Working Group: The Working Group may wish to note that alternative A is an abbreviated version of the approach followed in articles 4.1 and 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary ("the Hague Securities Convention"). The commentary will include the detailed fallback rules in article 5 of the Hague Securities Convention with sufficient explanation*.]

Alternative B

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

[*Note to the Working Group: The Working Group may wish to consider, as an alternative or supplementary provision, the law governing the control agreement (see A/CN.9/603, para. 77). The Working Group may also wish to note that the commentary will explain that the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter, apply to security rights in rights to payment of funds credited to a bank account*.]

Law applicable to the third-party effectiveness of a security right in specified types of asset by registration[64]

209. 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 determines whether the effectiveness against third parties of a security right in such encumbered asset has been achieved by registration under the laws of that State.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation provides that the State whose law governs the achievement of third-party effectiveness by registration with respect to security rights in the specified types of asset is the same State whose law governs the achievement of third-party effectiveness with respect to security rights in intangible property. Thus, secured creditors seeking to achieve third-party effectiveness by registration for security rights in the specified types of assets and in intangible property will need to comply with the registration system of only one State. Similarly, third parties seeking to determine whether any secured creditor is claiming a security right in the specified types of asset or in intangible property will need to search in the registration system of only one State. The commentary will also explain recommendation 209 applies only to third-party effectiveness achieved by registration (not by control or any other method) and does not determine the law governing priority. In addition, the commentary will explain that, under recommendation 89, a security right in a negotiable instrument made effective against third parties by registration is subordinate to a security made effective against third parties by possession with respect to the instrument. Similarly, under*

[64] See A/CN.9/611/Add.1, recommendation 140.

recommendation 92, a security right in a right to payment of funds credited to a bank account made effective by registration is subordinate to a security right made effective by control.]

Law applicable to a security right in proceeds under an independent undertaking[65]

210. The law should provide that the law of the State specified in the independent undertaking of the guarantor/issuer, confirmer or nominated person governs:

(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 proceeds under an independent undertaking against a guarantor/issuer, confirmer or nominated person; and

(c) Except to the extent otherwise provided in recommendation 212, the effectiveness against third parties and the priority as against the rights of competing claimants of a security right in proceeds under the independent undertaking.

211. If the applicable law is not specified in the independent undertaking of the guarantor/issuer, confirmer or nominated person, the law governing the matters referred to in recommendation 210 is the law of the State of the location of the branch or office of the guarantor/issuer, confirmer or nominated person indicated in the independent undertaking. However, in the case of a nominated person that has not issued an independent undertaking, 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.

212. The law should provide that, if a security right in proceeds under an independent undertaking is created and is made effective against third parties automatically as a result of the effectiveness against third parties of a security right in a receivable, negotiable instrument or other obligation, the payment or other performance of which the independent undertaking secures, the creation and the effectiveness against third parties of the security right in the proceeds under the independent undertaking is governed by the law of the State whose law governs the creation and the effectiveness against third parties of the security right in the secured receivable, negotiable instrument or other obligation.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendations 210 and 211 follow the conflict-of-laws rules applicable with respect to the rights and obligations of guarantor/issuers, confirmers or nominated persons. The only exception to the principle embodied in recommendations 210 and 211 is the rule in recommendation 212, for the limited issues of creation and third-party effectiveness in cases where a security right arises or is made effective against third parties automatically.*

In addition, the commentary will explain that each bank (or sometimes non-bank) performing one of these roles acts pursuant to the law where it is located, meaning where its relevant branch or office is located (or the law it chooses, which

[65] For recommendations 210-212, see A/CN.9/611/Add.1, recommendations 138 and 138 bis.

is typically the law of the State where its relevant branch or office is located). Accordingly, different laws govern the different banks involved, and a choice of law in an independent undertaking governs only the particular issuer's obligations (see Uniform Rules for Demand Guarantees article 27, Uniform Commercial Code 5-116(b), and United Nations Assignment Convention article 29). The commentary will also explain that what recommendation 211 strives to do is be clear that a request for acknowledgement or for payment (without prior acknowledgement) made by a secured creditor (or the beneficiary on its behalf) is to be handled by the affected bank branch under its local law.

Under recommendations 210 and 211, all priority conflicts are subject to the law chosen by a guarantor/issuer, confirmer or nominated person or, in the absence of a choice of law, to the law of the relevant branch or office. The Working Group may wish to consider the question whether: (a) if a bank branch pays (or gives value to) a secured creditor, then that same law should apply to that secured creditor's priority contest with third parties; and (b) if the payment is to the beneficiary and the priority contest is among third parties, recommendations 210 and 211 should be inapplicable and residual conflict-of-laws rules apply (i.e. recommendation 197).

The commentary will further explain that: (a) creation of the security right is governed by the general conflict-of-laws rule in recommendation 197 for security rights in intangibles (except as provided in recommendation 212 for automatic creation); and (b) enforcement of the security right is governed by the general conflict-of-laws rule in recommendation 200, except to the extent otherwise provided in recommendations 210 and 211.]

Law applicable to the rights and obligations of third-party obligors and secured creditors[66]

213. The law should provide that the following matters are governed by the law of the State whose law governs a receivable, negotiable instrument or negotiable document:

(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;

(b) The conditions under which the assignment of the receivable, a security right in the negotiable instrument or 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; and

(c) The determination of 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.

[66] See A/CN.9/611, recommendation 147.

C. Special rules when the applicable law is the law of a multi-unit State

[*Note to the Working Group: The Working Group may wish to note that recommendations 214-217 are intended to provide ex ante certainty as to the application of the recommendations not only by a multi-unit State but also, most importantly, by a unitary State when the law applicable is the law of a multi-unit State. If the Working Group considers that these recommendations are too detailed for a guide, it may wish to consider whether these matters should be addressed with more general recommendations and appropriate explanations in the commentary*.]

214. The law should provide that in applying the recommendations in this chapter to situations in which the State whose law governs an issue is a multi-unit State:

(a) Subject to subparagraph (b) of this recommendation, 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 recommendations in this chapter) and, to the extent applicable in that unit, to the law of the multi-unit State itself;

(b) If the law in force in a territorial unit of a multi-unit State designates the law of another territorial unit of that State to govern third-party effectiveness or priority, the law of that other territorial unit governs that issue.

215. The law should provide that if, under the recommendations in this chapter, the applicable law is that of a multi-unit State or one of its territorial units, the internal choice of law rules in force in that multi-unit State shall determine whether the substantive rules of law of that multi-unit State or of a particular territorial unit of that multi-unit State shall apply.

[*Note to the Working Group: The Working Group may wish to note that recommendations 214 and 215 track the language of article 12, paragraphs 2 and 3, of the Hague Securities Convention respectively. The Working Group may wish to consider a definition of "multi-unit State" along the lines of article 1, paragraph (1) (m) of that Convention ("multi-unit State" means a State within which two or more territorial units of that State, or both the State and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in the recommendations in the Guide)*.]

216. The law should provide that, if the account holder and the depositary bank have agreed on the law of a specified territorial unit of a multi-unit State:

(a) The references to "State" in the first sentence of recommendation 208 (alternative A) are to that territorial unit;

(b) The references to "that State" in the second sentence of recommendation 208 (alternative A) are to the multi-unit State itself.

217. The law should provide that the law of a territorial unit applies if:

(a) Under recommendation 208 (alternative A) and 216, the designated law is that of a territorial unit of a multi-unit State;

(b) Under the law of that State the law of a territorial unit applies only if the depositary bank has an office within that territorial unit which satisfies the condition specified in the second sentence of recommendation 208 (alternative A); and

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

[*Note to the Working Group: Recommendations 216 and 217, which track the language of article 12, paragraphs 1 and 4, of the Hague Securities Convention respectively, may be necessary if the Working Group decides to retain alternative A in recommendation 208*.]

XIV. Transition[67]

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

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

[*Note to the Working Group: The Working Group may wish to note that the commentary will clarify that, in determining the effective date, the State should take into account:*

(a) The impact of the effective date on credit transactions 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;

(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.]

Inapplicability of the law to disputes in litigation

219. The law should provide that:

(a) It does not apply to the rights and obligations of the parties to a security agreement if, at the effective date, they are the subject of litigation (or a comparable dispute resolution system); and

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[67] See A/CN.9/WG.VI/WP.26/Add.8.

(b) It does not affect enforcement of a security right to the extent the secured creditor has taken steps towards enforcing it.

Transition period

220. The law should provide a period of time after the effective date (the "transition period"), during which:

(a) A security right created under the law in effect immediately before the effective date continues to exist under this law;

(b) A security right made effective against third parties under the law in effect immediately before the effective date remains effective against third parties under this law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the "law in effect immediately before the effective date" is the law of the State whose law governed an issue under the conflict-of-laws rules of the previous regime*.]

Creation and third-party effectiveness of a security right

221. The law should provide that the existence of a security right created under the law in effect immediately before the effective date is determined by that law.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the main rule is that, while creation of a security right before the effective date of the new law is determined by the old law, third-party effectiveness and priority are in principle determined by the new law. The commentary will also explain that recommendations 222-224 are intended to preserve third-party effectiveness under the old law and to give some time to parties to achieve third-party effectiveness under the new law. Moreover the commentary will explain that recommendation 226 is designed to set out one exception to the rule on which law determines priority by providing that the old law applies if all competing rights were created and made effective against third parties under the old law and no change occurred since the effective date of the new law*.]

222. The law should provide that a security right made effective against third parties under the law in effect immediately before the effective date remains effective against third parties during the transition period. If, during the transition period or such longer period described in recommendation 223, the secured creditor takes any steps necessary to ensure that the security right is made effective against third parties under this law, its existence and effectiveness against third parties is continuous.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that, in cases in which the steps taken under the rules of the previous legal regimes also satisfy the requirements for third-party effectiveness under the new law, no additional steps need be taken. However, the commentary will also explain that a registration of a notice of a security right in a registry of a State other than the enacting State or in a different registry of the enacting State than provided in this law does not satisfy the requirements of this law; in such cases, recommendation 223 provides the applicable transition rule*.]

223. The law should provide that a security right created and made effective against third parties by registration of a notice under the law in effect immediately before the effective date remains effective against third parties until the earlier of:

(a) The date the registration would cease to be effective under that other law; and

(b) […] years after the effective date.

224. The law should provide that [, for purposes of applying its priority rules to a security right that was effective against third parties under the law in effect immediately before the effective date and is continuously effective against third parties under this law,] the date on which the security right was made effective against third parties or became the subject of a registered notice, as applicable, is the date on which such security right was made effective against third parties or became the subject of a registered notice under the law in effect immediately before the effective date.

Priority of a security right

225. Subject to recommendation 227, the law should provide that the priority of a security right as against the right of a competing claimant is governed by this law.

226. The law should provide that the priority of a security right as against the right of a competing claimant is determined by the law in effect immediately before the effective date if:

(a) Both the security right and the right of the competing claimant are created before the effective date; and

(b) The status of neither right has changed since the effective date.

227. The status of a security right has changed if:

(a) It was effective against third parties on the effective date in accordance with recommendation 222 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 Working Group: The Working Group may wish to note that the commentary will explain that the law should ensure that the transition should not entail any cost other than the nominal cost of registration of a notice of a security right.*]