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Draft Model Law on Secured Transactions

Note by the Secretariat

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Chapter I. Scope of application and general provisions

Article 1. Scope of application

1. This Law applies to security rights in movable assets.

2. With the exception of articles 80-93, this Law applies to outright transfers of receivables.

3. Notwithstanding paragraph 1, this Law does not apply to security rights in:

(a) The right to request payment under or to receive the proceeds of an independent undertaking;

(b) Intellectual property in so far as this Law is inconsistent with [the enacting State to specify its law relating to intellectual property];[1]

(c) Intermediated securities;

(d) Payment rights arising under or from financial contracts governed by [close-out] netting agreements, except a payment right arising upon the termination of all outstanding transactions;

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

(f) [The enacting State to set out other types of asset it wishes to exclude, such as those that are subject to specialized secured transactions and asset-based registration regimes under other law to the extent that that other law governs matters addressed in this Law].[2]

[4. This Law does not apply to security rights in proceeds of encumbered assets if the proceeds are a type of asset that is outside the scope of this Law to the extent that [the enacting State to specify any other law] applies to security rights in those types of asset and governs the matters addressed in this Law.]

5. [Nothing in this Law affects the application of] [This Law is subject to] laws relating to the protection of parties to transactions made for personal, family or household purposes.

6. [Nothing in this Law overrides a provision of any other law that limits the creation or enforcement of a security right in, or the transferability of, specific types of asset, with the exception of a provision that limits the creation or enforcement of a security right in or the transferability of an asset on the sole ground that it is a future asset, or a part or undivided interest in an asset].

[*Note to the Working Group: The Working Group may wish to consider whether certain types of outright transfers of receivables that are often excluded from the scope of secured transactions laws in several jurisdictions should also be excluded from the scope of the draft Model Law or at least discussed in the Guide to Enactment. In this regard the Working Group may wish to consider the following*

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[1] This provision may not be necessary if the enacting State has coordinated, or has otherwise addressed the relationship between this Law and any secured transactions provisions of its law relating to intellectual property.

[2] If the enacting State decides to introduce any other exception(s), they should be limited and set out in the Law in a clear and specific way.

possible exclusions: (a) Outright transfers of receivables as part of a sale of a business out of which they arose, unless the seller remains in apparent control of the business after the sale: the reason for this exclusion is that the potential that the transferor will be able to mislead other buyers of the receivables is very limited unless the old owner remains in apparent control of the business. Whether this exclusion is necessary will depend on whether the Working Group considers that a transfer of receivables incidental to the sale of all the assets of a business may be interpreted as a transfer of receivables subject to the draft Model Law. (b) Outright transfers of receivables made solely to facilitate the collection of the receivables for the transferor: the reason for this exclusion is that the transferee in this type of transaction effectively acts as an agent of the transferor and not as an independent transferee capable of asserting priority over another transferee, a result that may follow from the general rules of agency in the enacting State. (c) Outright transfers of a single receivable (or negotiable instrument) made in whole or in partial satisfaction of a pre-existing indebtedness: the reason for this exclusion is that a transferee might not think of having to register such a transaction or otherwise conform to the provisions of the draft Model Law. On the other hand, this exclusion could undermine the certainty and transparency sought to be achieved through otherwise incorporating the outright transfer of even a single receivable within the registration and priority rules of the draft Model Law. (d) Outright transfers of an unearned right to payment under a contract to a person who is to perform the transferor's obligations under the contract: the reason for this exclusion is that the transferee takes the place of the transferor and thus there is no risk of deception of third parties as to who is entitled to receive payment. On the other hand, this type of transaction would seem to involve a novation of the contract and not a simple transfer of a right to payment and therefore would fall within the scope of the draft Model Law in any event. (e) Outright transfer of present or future wages, salary, pay, commission, or any other compensation for labour or personal services of an employee: the reason for this exclusion is that such transfers are typically prohibited by other law. Thus, if they are excluded, they should be excluded only to the extent they are actually prohibited by other law of the enacting State. However, their exclusion may not be necessary as the draft Model Law preserves legal prohibitions to the transferability of or the creation of a security right in an asset under other law in any event (see art. 1, para. 5). (f) Outright transfers for the general benefit of creditors of the transferor: in many common law jurisdictions, an assignment for the general benefit of creditors operates as an alternative to formal insolvency proceedings or as a device for commencing voluntary insolvency proceedings. Thus, the Guide to Enactment may need to state that enacting States that follow this approach may need to clarify that the draft Model Law does not apply to such transfers. (g) Outright transfers of a right to damages in tort: the reason for this exclusion is that the transfer of tort claims is often prohibited by law, as these claims are personal or because of concerns that their use as security for credit may increase tort actions and insurance costs or interfere with the rights of the victims of torts. In this regard, it should be noted, that, unlike the United Nations Convention on the Assignment of Receivables in International Trade *(the "*Assignment Convention*") that applies only to contractual receivables, the draft Model Law applies to all types of receivables, including a prospective award of damages in a tort claim, a right to payment under a settlement contract pertaining to a tort claim and to proceeds of a damages claim that are deposited into a bank account. Accordingly, such an exclusion may be left to each enacting*

State rather than included in the Model Law. (h) Outright transfers of an interest in or claim under a contact of insurance: the reason for this exclusion is that such transactions may be adequately covered by existing law of the enacting State. However, such an exclusion could have a negative impact on the availability of credit on the basis of insurance policy proceeds and would run counter to the policy of the Secured Transactions Guide*, which defines "proceeds" as to include insurance policy proceeds. With respect to subparagraph 3(d), the Working Group may wish to note that, unlike recommendation 4, subparagraph (d), of the* Secured Transactions Guide *which refers to "netting", subparagraph 3(d) refers to "close-out netting". The Working Group may wish to note that the Guide to Enactment will explain that this change of wording is necessary to ensure that transactions relating to set off even between two sellers of goods with trade claims and counter-claims would not be inadvertently excluded (see A/CN.9/830, para. 20). With respect to subparagraph 3(e), the Working Group may wish to consider whether the exclusion of payment rights arising under or from financial contracts governed by [close-out] netting agreements in subparagraph 3(d) is sufficient to cover also payment rights arising under or from foreign exchange transactions addressed in subparagraph 3(e) and, if so, whether subparagraph 3(e) should be deleted. The Working Group may wish to consider subparagraphs 3(d) and (e) together with the definitions of the terms "financial contract" and "[close-out] netting" in article 2, which are based on the definitions of those terms contained in article 5 of the* Assignment Convention*. With respect to paragraph 6, the Working Group may wish to consider the bracketed wording, which is intended to ensure that statutory limitations to the transferability of future assets, parts of and undivided interests in assets is overridden by the draft Model Law (see also recommendation 23 of the* Secured Transactions Guide*, which has not been reflected in any article of the draft Model Law)*.]

Article 2. Definitions and rules of interpretation

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will also refer to other rules of interpretation, such as the following: (a) the word "or" is not intended to be exclusive; (b) the singular includes the plural and vice versa; and (c) the words "include" or "including" are not intended to indicate an exhaustive list (see* Secured Transactions Guide*, Introduction, para. 17)*.]

For the purposes of this Law:

(a) "Acquisition secured creditor" means a secured creditor that has an acquisition security right;

(b) "Acquisition security right" means a security right in a tangible asset, intellectual property or the rights of a licensee under a licence of intellectual property that secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit otherwise provided to enable the grantor to acquire it [to the extent the credit is in fact applied for that purpose];

[*Note to the Working Group: The Working Group may wish to note that the term "tangible asset" throughout the draft Model Law means tangible assets in the strict sense, including consumer goods, equipment and inventory and excluding money, negotiable instruments, negotiable documents and certificated*

non-intermediated securities (see definition of "tangible asset" below). However, all types of asset that may be subject to physical possession are included in the definition of the term "possession" below. The Working Group may also wish to consider the wording within square brackets in this definition, which is intended to ensure that a security right qualifies as an acquisition security right only if the credit provided for the purpose of acquiring the encumbered asset is in fact used for that purpose. The Working Group may further wish to consider whether it is redundant to refer to "an obligation incurred or credit otherwise provided" or whether it is sufficient to simply refer to "other credit extended". The Working Group may also wish to consider whether the Guide to Enactment should explain that, where a security right secures obligations in addition to the credit extended and used for the purpose of acquiring the encumbered asset, it is an ordinary security right to the extent of those additional obligations.]

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

[*Note to the Working Group: The Working Group may wish to consider the bracketed text in this definition, which is intended to draw a clear distinction from a securities account in which funds are routinely credited or debited when transactions relating to securities credited to those accounts are settled. Alternatively, this distinction may be explained in the Guide to Enactment, which can explain that, to underline this distinction, the draft Model Law defines the term "securities account" as "an account maintained by an intermediary to whom securities may be credited or debited" and the term "securities" in a manner that clearly excludes funds. The Working Group may further wish to consider whether it is appropriate to retain the second sentence of this definition since the terms "checking or other current account" and "savings or time deposit account" are business terms rather than legal terms and therefore may not be used in all enacting States or have the same meaning in all enacting States. These terms may instead be used in the Guide to Enactment as examples. The Guide to Enactment will also explain that the enacting State may wish to include a definition of the term "bank" in its secured transactions law or rely for this purpose on other law*.]

(d) "Certificated non-intermediated securities" means non-intermediated securities represented by a certificate that:

(i) Provides that the person entitled to the securities is the person in possession of the certificate; or

(ii) Identifies the person entitled to the securities;

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that the term "represented" is broad enough to cover the approaches taken in different jurisdictions and that the term "certificate" means only a tangible document subject to physical possession*.]

(e) "Competing claimant" means a creditor of a grantor or other person with rights in an encumbered asset that may be in conflict with the rights of a secured creditor in the same encumbered asset and includes:

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

(ii) Another creditor of the grantor that has a right in the same encumbered asset, such as a judgement creditor or [the enacting State to specify creditors that have a right in the encumbered asset under other law];

(iii) The insolvency representative in insolvency proceedings in respect of the grantor; or

(iv) A buyer [or other transferee], lessee or licensee of the encumbered asset;

[*Note to the Working Group: The Working Group may wish to note that the text in square brackets in subparagraph (e)(iv) has been included to align this definition with the formulation of other articles (see, for example, arts. 42 and 43). The Working Group may also wish to note that, if the bracketed text is to be retained, its position may have to be reconsidered as in some jurisdictions lessees and licensees are considered transferees*.]

(f) "Consumer goods" means goods [primarily] used or intended to be used by a physical person for personal, family or household purposes;

[*Note to the Working Group: The Working Group also may wish to add the word "primarily" to this definition to cover the case where goods are used by the grantor for both business and personal purposes in which event the primary use would determine whether they qualify as consumer goods. The Working Group may also wish to consider whether the definitions of the terms "equipment" and "inventory" should also be revised to refer to tangible assets "*primarily used or intended to be used …*".*]

(g) "Control agreement":

(i) With respect to uncertificated non-intermediated securities means an agreement in writing among the issuer, the grantor and the secured creditor, according to which the issuer agrees to follow instructions from the secured creditor with respect to the securities without further consent from the grantor; and

(ii) With respect to rights to payment of funds credited to a bank account means an agreement in writing among the depositary bank, the grantor and the secured creditor, according to which the depositary bank agrees to follow instructions from the secured creditor with respect to the payment of the funds credited to the bank account without further consent from the grantor;

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that: (a) the enacting State may wish to add a reference to its requirements for the authorization of an agreement (e.g. signature); and (b) a control agreement does not need to be in a single writing*.]

(h) "Debtor" means a person that owes payment or other performance of a secured obligation, whether or not that person is the grantor of the security right secured by that obligation. The term includes a secondary obligor such as a

guarantor of a secured obligation, and a transferor in an outright transfer of a receivable;

(i) "Debtor of the receivable" means a person that owes payment of a receivable. The term includes a guarantor or other person secondarily liable for payment of the receivable;

(j) "Encumbered asset" means a tangible or intangible movable asset that is subject to a security right. The term includes a receivable that is the subject of an outright transfer;

(k) "Equipment" means a tangible asset [primarily] used [or intended to be used] by a person in the operation of its business;

(l) "Financial contract" means a contract relating to any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to those transactions entered into in financial markets and any combination of those transactions;

(m) "Future asset" means a tangible or intangible movable asset, which does not exist or which the grantor does not have rights in or the power to encumber at the time the security agreement is concluded;

(n) "Grantor" means a person that creates a security right to secure either its own obligation or that of another person. The term includes the transferor in an outright transfer of a receivable;

(o) "Independent undertaking" means an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person.

[*Note to the Working Group: The Working Group may wish to note that this definition is based on the definition contained in article 2, paragraph (1) of the* United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.]

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

(q) "Intangible asset" means all forms of movable assets other than tangible assets. The term includes receivables, rights to the performance of obligations other than receivables, rights to payment of funds credited to a bank account, money, negotiable instruments, negotiable documents and non-intermediated securities;

[*Note to the Working Group: The Working Group may wish to note that, in view of the narrow definition of the term "tangible asset" (in line with the way it is*

used in the draft Model Law), the definition of the term "intangible asset" includes some types of asset that may be subject to physical possession and thus are included in the definition of the term "possession". The Working Group may wish to consider the use of the terms "intangible asset", "possession" and "tangible asset", and consider whether these definitions should be revised.]

(r) "Inventory" means tangible assets [primarily] held by a person for sale or licence in the ordinary course of the grantor's business. The term includes raw and semi-processed materials (work-in-process);

(s) "Knowledge" means actual knowledge;

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

(u) "Money" means currency currently authorized as legal tender by any State. The term does not include funds credited to a bank account or negotiable instruments;

[*Note to the Working Group: The Working Group may wish to note that the term "money", whose definition is based on a definition contained in the* Secured Transactions Guide*, is intended to include not only the national currency of the enacting State but also foreign currency. The Working Group may wish to consider deleting the word "currently" in this definition as redundant (since if currency is not "currently authorized" as "legal tender", then it would not qualify as "legal tender"). The Working Group may also wish to consider deleting the second sentence of the definition since rights to payment of funds credited to a bank account and negotiable instruments are recognized as distinct concepts in the draft Model Law and thus it is already clear that the concept "money" does not include them. All these matters may be usefully discussed in the Guide to Enactment*.]

(v) "Non-intermediated securities" means securities other than securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account;

[*Note to the Working Group: The Working Group may wish to note the Guide to Enactment will explain that the term "non-intermediated securities" does not include the rights of an intermediary or a competing claimant in securities held by the intermediary directly against the issuer because those securities are credited by the intermediary to a securities account in the name of the grantor and therefore qualify as intermediated securities for the purposes of that transaction*.]

(w) "[Close-out netting] [Netting] agreement" means an agreement between two or more parties that provides for one or more of the following:

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

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

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

(x) "Notice" means a communication in writing;

[*Note to the Working Group: In view of the definitions of the term "notice" in the* Secured Transactions Guide *and in the* UNCITRAL Guide on the Implementation of a Security Rights Registry *(the "*Registry Guide*") and to avoid any ambiguity between a notice registered in the general security rights registry and a notice of enforcement, the Working Group may wish to consider whether a new term should be introduced and defined in this article to reflect a notice to be registered in the general security rights registry, while the current definition of the term "notice" could be retained to refer to other types of notice (e.g., given in the context of enforcement). The new term could be "security right notice" or "registry notice" and be defined along the following lines: "means a communication to the Registry in writing in the form prescribed by the [Registry] [Regulation] [other Law relating to the registration of notices of security rights]". Alternatively, wording along the following lines could be included in the definition of the term "notice": "and, in the context of the provisions in this Law that govern the registration of a notice in the security rights registry, means a communication in writing in the form prescribed by the [Registry] [Regulation] [other Law relating to the registration of notices of security rights"*.]

(y) "Notification of a security right in a receivable" means a notice by the grantor or the secured creditor informing the debtor of the receivable that a security right has been created in the receivable. A notification of the security right may include a payment instruction;

[*Note to the Working Group: The Working Group may wish to note that the requirement for the identification of the encumbered receivable and the secured creditor that was included in a previous version of this definition (and in this definition in the* Secured Transactions Guide*), was moved to article 70, paragraph 1, as it states a substantive rule on the effectiveness of a notification of a security right, a matter that is already addressed in article 70, paragraph 1. The Working Group may wish to consider whether the second sentence of this definition also states a substantive rule and should be moved to article 70*.]

(z) "Possession" means the actual [physical] possession of a tangible asset, money, negotiable instruments, negotiable documents and certificated non-intermediated securities by a person or its representative, or by an independent person that acknowledges holding it for that person;

[*Note to the Working Group: The Working Group may wish to note that the definition of "possession" has been revised to refer to all types of tangible asset that may be subject to physical possession (see definitions of terms "tangible asset" and intangible asset")*.]

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

(bb) "Proceeds" means whatever is received in respect of an encumbered asset. The term includes what is received as a result of sale or other disposition or collection, lease or licence of an encumbered asset, civil and natural fruits,

insurance proceeds, claims arising from defects in, damage to or loss of an encumbered asset, and proceeds of proceeds;

[*Note to the Working Group: The Working Group may wish to consider whether the definition of the term "proceeds" should be limited to proceeds received by the grantor, and not extend to proceeds received, for example, by a transferee of the original encumbered asset. A different approach could potentially prejudice a third party that acquired proceeds from a transferee and had no means of knowing or finding out that the asset was the proceeds of an asset in which somebody held a security right (e.g. grantor sells the encumbered asset, a green widget, to X who then trades it in for a blue widget and then sells the blue widget to Y. Y has no means of knowing or finding out that the blue widget is subject to a security right created by the grantor/transferor). The Working Group may wish to note that the Guide to Enactment will explain that the term "civil fruits" covers revenues, dividends and distributions*.]

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

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

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

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

[*Note to the Working Group: The Working Group may wish to note that the definition of this term is included here only for the purposes of the articles in which this term is used, that is, article 1, subparagraph 3(a), under which the right to receive the proceeds is excluded from the scope of the draft Model Law, and article 1, paragraph 4, under which the proceeds of an excluded type of asset are also excluded*.]

(ee) "Secured creditor" means a creditor that has a security right. The term includes a transferee in an outright transfer of a receivable;

(ff) "Secured obligation" means an obligation secured by a security right. This term does not apply to outright transfers of receivables;

(gg) "Security agreement" means an agreement, regardless of whether the parties have denominated it as a security agreement, between a grantor and a secured creditor that creates a security right. The term also includes an agreement for the outright transfer of a receivable;

(hh) "Securities" means:

[(i)] An obligation of an issuer or any share or similar right of participation in an issuer or in the enterprise of an issuer that:

a. Is one of a class or series, or by its terms is divisible into a class or series, of obligations, shares or participations; and

b. Is, or is of a type, dealt in or traded on securities exchanges or financial markets, or is a medium for investment in the area in which it is issued or dealt in or traded; [or]

[(ii) The enacting State to specify any additional rights that should qualify as securities even if they do not satisfy the requirements expressed in subparagraphs (i) a. and (i) b;]

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that each enacting State would need to coordinate the definition of the term "securities" in its secured transactions law with the definition of this term in its securities transfer law*.]

(ii) "Securities account" means an account maintained by an intermediary to which securities may be credited or debited;

[*Note to the Working Group: The Working Group may wish to note that this definition is derived from article 1, subparagraph (c), of the Geneva Securities Convention*.]

(jj) "Security right" means a property right in a movable asset that is created by an agreement to secure payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right, and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation. The term also includes the right of the transferee in an outright transfer of a receivable;

(kk) "Tangible asset" means all forms of goods. The term includes consumer goods, equipment and inventory [but not money, negotiable instruments, negotiable documents or certificated non-intermediated securities.]

[*Note to the Working Group: The Working Group may wish to consider whether: (a) the draft Model Law should use the term "goods" to define the term "tangible asset" given that this concept has a particular legal meaning in common law jurisdictions and may not translate easily to other languages; (b) the terms consumer goods, equipment and inventory should be deleted as unnecessary and perhaps confusing since these terms do not refer to subcategories of tangible assets but rather to the way in which particular tangible assets are used by the grantor (thus, the same car could qualify as "consumer goods" if it is used by the grantor for personal purposes, or as "equipment" if it is used by the grantor in its business, or as "inventory" if the grantor happens to be a car dealer or manufacturer); (c) for greater clarity, money, negotiable instruments, negotiable documents and certificated non-intermediated securities should be excluded from this definition or (included in the definition of "intangible asset") since these types of asset are treated in some jurisdictions as tangible assets, but in the draft Model Law are subject to asset-specific rules*.]

(ll) "Uncertificated non-intermediated securities" means non-intermediated securities not represented by a certificate.

Article 3. International obligations of this State

To the extent that this Law conflicts with an obligation of this State arising out of any treaty or other form of agreement to which it is a party with one or more other States, the requirements of the treaty or agreement prevail.

[*Note to the Working Group: The Working Group may wish to note that, at its twenty-sixth session, it agreed that this article should be based on article 3 of the UNCITRAL Model Law on Cross-Border Insolvency or on article 38 of the Assignment Convention (see A/CN.9/830, para. 17). However, the latter provision, which refers only to international agreements and to agreements that specifically govern a transaction governed by the* Assignment Convention*, contains a rule of hierarchy among international agreements (the specific prevails over the general text) rather than a domestic law rule dealing with the prevalence of international treaties over domestic law. To explicitly preserve the application of regional law (e.g. EU directives), the Working Group may also wish to consider including in this article a second paragraph that could read along the following lines: "This Law does not affect the application of the rules of a Regional Economic Integration Organisation, whether adopted before or after this Law" (see art. 26(6) of the Hague Convention on Choice of Court Agreements of 30 June 2005)*.]

Article 4. Party autonomy

1. Except as otherwise provided in articles [5, 6, 9, 62, 63, 81, paragraph 1, 47-50, 96-111], the provisions of this Law may be derogated from or varied by agreement.

2. An agreement referred to in paragraph 1 does not [negatively] affect the rights or obligations of any person that is not a party to the agreement.

[*Note to the Working Group: The Working Group may wish to consider whether paragraph 2 should rather refer to a negative effect or modification of third-party rights, as an agreement may have an indirect effect on or benefit to third-party rights (e.g. a subordination agreement)*.]

Article 5. General standards of conduct

1. A person must exercise its rights and perform its obligations under this Law in good faith and in a commercially reasonable manner.

2. The general standards of conduct set forth in paragraph 1 cannot be waived unilaterally or varied by agreement.

[*Note to the Working Group: The Working Group may wish to consider whether paragraph 2 is necessary given that article 4 already states that the rule embodied in this article cannot be waived unilaterally or varied by agreement. The Working Group may wish to note that the Guide to Enactment will explain that: (a) the concept of "commercial reasonableness" refers to the commercial context and best practices; and (b) meeting the specific standards referred to in other articles of this Law would generally be construed as meeting the general standards of conduct referred to in this article (see A/CN.9/830, paras. 31-33)*.]

Chapter II. Creation of a security right

A. General rules

Article 6. Security agreement

1. A security right is created by a security agreement that satisfies the requirements of paragraphs 2 to 5, provided that the grantor has rights in the asset to be encumbered or the power to encumber it.

2. A security agreement may provide for the creation of a security right in a future asset, but the security right in that asset is created only at the time when the grantor acquires rights in it or the power to encumber it.

3. A security agreement must:

(a) Provide for the creation of a security right;

(b) Identify the secured creditor and the grantor;

(c) Describe the secured obligation;

(d) Describe the encumbered assets as provided in article 9 [; and

(e) Indicate the maximum monetary amount for which the security right may be enforced].[3]

4. Except as provided in paragraph 5, a security agreement must be [the enacting State should specify whether the security agreement must be "concluded in" or "evidenced by" a writing] that satisfies the requirements of paragraph 3 and is signed by the grantor.

5. A security agreement may be oral if the secured creditor has possession [or control] of the encumbered asset.

[*Note to the Working Group: The Working Group may wish to consider whether the requirements set out in paragraph 2 apply only to situations in which a written security agreement is required (i.e. they do not apply to possessory security rights where an oral security agreement is permitted). In this regard, the Working Group may wish to note that, in the case of oral security agreements: (a) requirements (a)-(c) are already covered by paragraph 1 of this article insofar as it refers to the creation of a "security right" and requires a "security agreement", as defined in the draft Model Law; and (b) requirements (d) and (e) by their very nature are inapplicable to the situation where an oral security agreement is permitted because, where there is possession: (i) there is no need for a description that identifies the encumbered asset adequately since the very fact of possession satisfies the description requirement; and (ii) the requirement to agree to a maximum amount to be secured is inapplicable since this requirement is practically capable of being satisfied only if there is a written agreement. If the Working Group decides to delete paragraph 2, paragraph 3 should be revised to read along the following lines: "… a writing that: (a) identifies the secured creditor*

[3] The enacting State may wish to include this subparagraph in the draft Model Law if it determines that an indication of the maximum monetary amount for which the security right may be enforced would be helpful to facilitate lending from another creditor.

and the grantor; (b) Describes the secured obligation; (c) Describes the encumbered assets as provided in article 9; (d) Is signed by the grantor[; and (e) Indicates the maximum monetary amount for which the security right may be enforced". The Working Group may wish to note that the Guide to Enactment will explain that the enacting State may wish to select in paragraph 4 one of the two alterative wordings that are set out within square brackets. The Working Group may wish to consider the bracketed text in paragraph 5, which would dispense with the need for a written security agreement if the secured creditor has control with respect to a bank account or non-intermediated security.]

Article 7. Obligations that may be secured

A security right may secure any type of obligation, present or future, determined or determinable, conditional or unconditional, fixed or fluctuating.

Article 8. Assets that may be encumbered

A security right may encumber:

(a) Any type of movable asset, including future assets;

(b) Parts of assets and undivided rights in movable assets;

(c) Generic categories of movable assets; and

(d) All of a grantor's movable assets.

[Article 9. Required description of assets

1. [For the purpose of satisfying the requirements for a [written] security agreement referred to in article 6, paragraph 3, the] [The] assets to be encumbered must be described in the security agreement in a manner that reasonably allows their identification.

2. A generic description that refers to all assets within a category of assets or to all of the grantor's assets meets the standard referred to in paragraph 1.]

[*Note to the Working Group: The Working Group may wish to consider the bracketed text in paragraph 1, which is intended to limit the application of this article to written agreements. The Working Group may also wish to note that, in view of their importance, the requirements for the description of encumbered assets have been moved from article 6, subparagraph 3(d) to this new article.*]

Article 10. Proceeds

1. A security right in an asset extends to its identifiable proceeds.

2. Notwithstanding paragraph 1, where proceeds in the form of funds credited to a bank account or money are commingled with other assets of the same kind the security right extends to the commingled assets.

3. Subject to paragraph 4, the obligation secured by a security right that continues in commingled assets in accordance with paragraph 2 is limited to the value of the proceeds immediately before they were commingled.

4. If at any time after the commingling, the value of the balance credited to the bank account or of the commingled money is less than the value of the proceeds immediately before they were commingled, the obligation secured by the security right that continues in the commingled assets in accordance with paragraph 2 is limited to the lowest value between the time when the proceeds were commingled and the time the security right in the proceeds is claimed.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that, if new proceeds are deposited after the account or pool of money is depleted below the value of the proceeds originally deposited or contributed, then one would need to reapply these same rules to these later proceeds (i.e. the amount of each proceeds claim must be assessed separately)*.]

Article 11. Assets commingled in a mass or product

1. A security right in a tangible asset that is commingled in a mass or product extends to the mass or product.

2. The obligation secured by a security right that continues in a mass or product in accordance with paragraph 1 is limited to the value of the encumbered asset immediately before it became part of the mass or product.

[3. Where more than one security right continues in the same mass or product in accordance with paragraph 1 and each was a security right in a separate tangible asset at the time of commingling, the secured creditors are entitled to share in the mass or product according to the ratio that the obligation secured by each security right bears to the sum of the obligations secured by all security rights.]

[*Note to the Working Group: The Working Group may wish to note that paragraph 3 has been added to more closely align this article with recommendations 22 and 91 of the* Secured Transactions Guide.]

B. Asset-specific rules

Article 12. Contractual limitations on the creation of a security right

1. A security right in a receivable or other intangible asset, negotiable instrument or right to payment of funds credited to a bank account is effective as between the grantor and the secured creditor and as against the debtor of the receivable or other intangible asset, the obligor under a negotiable instrument, or the depositary bank notwithstanding an agreement limiting in any way the grantor's right to create a security right entered into between the initial or any subsequent grantor and:

(a) The debtor of the receivable or other intangible asset, the obligor under the negotiable instrument or the depositary bank; or

(b) Any subsequent secured creditor.

2. Nothing in this article affects any obligation or liability of the grantor for breach of the agreement referred to in paragraph 1, but the other party to the agreement may not avoid the contract giving rise to [the receivable or other intangible asset, negotiable instrument or right to payment of funds credited to a bank account] [the encumbered asset] or the security agreement on the sole ground

of the breach of that agreement[, or raise against the secured creditor any claim it may have as a result of such a breach against the grantor, as provided in article 72, paragraph 2].

3. A person that is not a party to the agreement referred to in paragraph 1 is not liable for the grantor's breach of the agreement on the sole ground that it had knowledge of the agreement.

4. This article applies only to receivables:

(a) Arising from a 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;

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

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

(d) Arising upon [net settlement of payments due pursuant to a netting agreement involving more than two parties] [the termination of all outstanding transactions].

[*Note to the Working Group: The Working Group may wish to note that this article, which is based on recommendation 24 of the* Secured Transactions Guide*, which in turn is based on article 9 of the* United Nations Convention on the Assignment of Receivables in International Trade *(the "*United Nations Assignment Convention*"), has been revised to address contractual limitations on the creation of a security right in assets in addition to receivables, namely other intangible assets, negotiable instruments and rights to payment of funds credited to a bank account (see A/CN.9/830, paras. 59-63). The Working Group may wish to consider the two sets of bracketed wording in paragraph 4(d) (the first set is based on rec. 24, subpara. (f)(iv) of the* Secured Transactions Guide *and while the second set is based on art. 1, subpara. 3(d) of the draft Model Law).*]

Article 13. Personal or property rights securing or supporting payment or other performance of an encumbered receivable or other intangible asset, or negotiable instrument

Alternative A

1. A secured creditor with a security right in a receivable or other intangible asset, or a negotiable instrument has the benefit of any personal or property right that secures or supports payment or other performance of the encumbered asset without any further action by either the grantor or the secured creditor.

2. If the right referred to in paragraph 1 is an independent undertaking, the security right automatically extends to the right to receive the proceeds of, but not the right to draw under, the independent undertaking.

Alternative B

1. A security right in a receivable or other intangible asset, or a negotiable instrument extends to any personal or property right that secures or supports

payment or other performance of the encumbered asset that is transferable without a new act of transfer.

2. If the right referred to in paragraph 1 of this article is transferable only with a new act of transfer, the grantor is obliged to create a security right in it in favour of the secured creditor.

[3. This article does not affect a right in immovable property that under other law is transferable separately from the obligation that the right in the immovable property secures.]

4. Paragraph 1 does not affect any duties of the grantor to the debtor of the receivable or other intangible asset, or the obligor of the negotiable instrument.

5. To the extent that the automatic effects of paragraph 1 are not impaired, this article does not affect any requirement under other law relating to the form or registration of the creation of a security right in any asset that is not covered in this Law.

[*Note to the Working Group: The Working Group may wish to consider alternatives A and B of paragraphs 1 and 2 of this article. Alternative A reflects the thrust of recommendation 25 of the* Secured Transactions Guide*, while alternative B reflects the thrust of article 10 of the* Assignment Convention *(rather than rec. 25). Under alternative B, the security right extends automatically to accessory security or supporting rights, while with respect to independent rights, the grantor is obliged to create a security right in them in favour of the secured creditor. Thus, there is no inconsistency with article 1, subparagraph 3(a), and there is no need to also include the full text of recommendation 127 of the* Secured Transactions Guide *to protect the rights of a guarantor/issuer, confirmer or nominated person of an independent undertaking. If alternative A were preferred, the Working Group may wish to consider whether the thrust of recommendation 127 (which has not been included in the draft Model Law as it does not apply to the right to receive the proceeds under an independent undertaking), should also be included in this article to avoid any adverse impact on the rights of a guarantor/issuer, confirmer or nominated person of an independent undertaking. The Working Group may wish to consider whether paragraph 4 should be retained in view of the fact that articles 70, 77 and 78 have been included in the draft Model Law so as to ensure that the rights of the debtor of an encumbered receivable and the obligor of an encumbered negotiable instrument under other law are protected. In this connection, the Working Group may wish to note that there is no provision equivalent to articles 70, 77 and 78 to preserve the rights of an obligor of an intangible asset other than a receivable*.]

Article 14. Negotiable documents and tangible assets covered

A security right in a negotiable document extends to the tangible asset covered by the document, provided that the issuer of the negotiable document is in possession of the asset[, 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 Guide to Enactment will explain that in view of the definition of the term "possession" in article 2, possession of the issuer includes possession by its representative or a person acting on behalf of the issuer. The Working Group may*

wish to consider whether the bracketed wording, which comes from recommendation 28 of the Secured Transactions Guide*, should be retained. The Guide to Enactment will also explain that a security right in a negotiable document extends to the tangible assets covered by the document and will continue to exist even after the document no longer covers the assets. However, effectiveness against third parties through possession of the document applies only as long as the document covers the assets, but not once they are released by the issuer (see art. 24, para. 2, below.)*]

Article 15. Tangible assets with respect to which intellectual property is used

A security right in a tangible asset with respect to which intellectual property is used does not extend to the intellectual property and a security right in the intellectual property does not extend to the tangible asset.

Chapter III. Effectiveness of a security right against third parties

A. General rules

Article 16. General methods for achieving third-party effectiveness

A security right in an asset is effective against third parties if:

(a) A notice with respect to the security right is registered in the general security rights registry (the "Registry") [or in any specialized registry or title certificate to be specified by the enacting State][4]; or

(b) The secured creditor has possession of that asset.

Article 17. Proceeds

1. If a security right in an asset is effective against third parties, a security right in any proceeds of that asset is effective against third parties without any further action by the grantor or the secured creditor if the proceeds are in the form of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

2. If a security right in an asset is effective against third parties, a security right in any type of proceeds of that asset other than the types of proceeds referred to in paragraph 1 is effective against third parties:

(a) For [a short period of time to be specified by the enacting State] days after the proceeds arise; and

(b) Thereafter, if the security right in the proceeds is made effective against third parties by one of the methods applicable to the relevant type of encumbered asset referred to in this chapter before the expiry of the time period provided in subparagraph (a).

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[4] An enacting State may wish to implement this provision if it has a specialized registration system.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that, unlike recommendation 39 of the* Secured Transactions Guide*, paragraph 1 does not refer to the description of the proceeds in the notice as, once the proceeds are described in the notice (in line with the security agreement), they constitute original encumbered assets, not proceeds, and article 16 was sufficient in dealing with the third-party effectiveness of a security right in those assets*.]

Article 18. Changes in the method for achieving third-party effectiveness

1. A security right made effective against third parties by one of the methods provided in this chapter may subsequently be made effective against third parties by any other method applicable to the relevant type of encumbered asset.

2. A security right that is effective against third parties remains effective against third parties despite a change in the method for achieving third-party effectiveness, provided that there is no time when the security right is not effective against third parties.

Article 19. Lapse in third-party effectiveness

1. If third-party effectiveness of a security right lapses, it may be re-established by any of the methods applicable to the relevant encumbered asset provided in this chapter.

2. If the third-party effectiveness of security right is re-established under paragraph 1, the security right is effective against third parties only as of the time its third-party effectiveness is re-established.

Article 20. Impact of a transfer of an encumbered asset

Except as provided in article 37, a security right in an asset remains effective against third parties even if the asset is sold or otherwise transferred, leased or licensed.

[*Note to the Working Group: The Working Group may wish to consider whether the rule that a security right follows an encumbered asset in the hands of a transferee fits more in the chapter on third-party effectiveness (impact on registration; see art. 37) and in the chapter on priority (authorization of the transfer by the secured creditor or transfer in the ordinary course of business of the transferor; see art. 42, paras. 2 to 8)*.]

Article 21. Change of the applicable law to this Law

1. If a security right is effective against third parties under the law of another State and this Law becomes applicable, the security right remains effective against third parties under this Law for [a short period of time to be specified by the enacting State] days after the change and, thereafter, only if the third-party effectiveness requirements of this Law are satisfied before the expiry of that time period.

2. If the security right remains effective against third parties under paragraph 1, the time of third-party effectiveness is the time when it was achieved under the law of the other State.

Article 22. Acquisition security rights in consumer goods

An acquisition security right in consumer goods is effective against third parties upon its creation without any further action by the grantor or the secured creditor.

B. Asset-specific rules

Article 23. Rights to payment of funds credited to a bank account

A security right in a right to payment of funds credited to a bank account may also be made effective against third parties by:

(a) The security right being created in favour of the depositary bank;

(b) Conclusion of a control agreement; or

(c) The secured creditor becoming the account holder.

Article 24. Negotiable documents and tangible assets covered

1. If a security right in a negotiable document is effective against third parties, the security right that extends to the asset covered by the document in accordance with article 14 is also effective against third parties.

2. During the period when a negotiable document covers an asset, a security right in the asset may be made effective against third parties by the secured creditor's possession of the document.

3. A security right in a negotiable document that was made effective against third parties by the secured creditor's possession of the document remains effective against third parties for [a short period of time to be specified by the enacting State] after the negotiable document has been relinquished to the grantor or other person for the purpose of ultimate sale or exchange, loading or unloading, or otherwise dealing with the assets covered by the negotiable document.

Article 25. Non-intermediated securities

A security right in uncertificated non-intermediated securities may also be made effective against third parties by:

(a) Notation of the security right or entry of the name of the secured creditor as the holder of the securities in the books maintained for that purpose by or on behalf of the issuer; or

(b) Conclusion of a control agreement.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that States parties to the* Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes *(Geneva, 1930; the "*Geneva Uniform Law*") may wish to include in the asset-specific section of the creation or third-party effectiveness chapter a provision that a security right may be created and made effective against third parties by delivery and endorsement containing the statement "value in security" ("valeur en garantie"), "value in pledge" ("valeur en gage"), or any other statement implying a security right (see*

art. 19; art. 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes*; the "*Bills and Notes Convention*" contains a similar rule). An enacting State that decides to do so will have to adjust article 60 of the draft Model Law to deal with the comparative priority of such a security right*.]