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Draft Guide to Enactment of the UNCITRAL Model Law on Secured Transactions

Note by the Secretariat

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Preface

At its forty-eighth session, in 2015, the Commission considered and approved the substance of article 26 of chapter IV of the draft Model Law on Secured Transactions and articles 1-29 of the draft Registry Act.[1]

At that session, the Commission also agreed that a guide to enactment of the Model Law should be prepared and referred that task to Working Group VI (Security Interests).[2]

At its forty-ninth session, in 2016, the Commission considered and adopted the UNCITRAL Model Law on Secured Transactions (the decision of the Commission and the relevant General Assembly resolution are contained in annexes I and II respectively).[3]

At that session, the Commission also noted that the Guide to Enactment was already at an advanced stage and was an extremely important text for the implementation and interpretation of the Model Law, and gave Working Group VI up to two sessions to complete its work and submit the Guide to Enactment to the Commission for final consideration and adoption at its fiftieth session in 2017.[4]

At its thirtieth and thirty-first sessions in December 2016 and February 2017, Working Group VI approved the substance of the draft Guide to Enactment.[5]

[At its fiftieth session, in 2017, the Commission considered and adopted the Guide to Enactment to the UNCITRAL Model Law on Secured Transactions (the decision of the Commission and the relevant General Assembly resolution are contained in annexes III and IV respectively).[6]]

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[1] *Official Records of the General Assembly, Seventieth Session, Supplement No. 17* (A/70/17), para. 214. The draft Model Law and the draft registry Act are contained in documents A/CN.9/852 and A/CN.9/853.

[2] Ibid., para. 216.

[3] Ibid., *Seventy-first Session, Supplement No. 17* (A/71/17), paras. 17-118. The draft Model Law, including the draft Model Registry-related Provisions, is contained in documents A/CN.9/884 and Add.1-4; the draft Guide to Enactment of the Model Law is contained in documents A/CN.9/885 and Add.1-4; and the compilation of comments by States is contained in documents A/CN.9/886, A/CN.9/887 and Add.1.

[4] Ibid., paras. 121 and 122.

[5] The reports of the Working Group are contained in documents A/CN.9/899 and A/CN.9/904. During these sessions, the Working Group considered documents A/CN.9/WG.VI/WP.71/Add.1-6 and A/CN.9/WG.VI/WP.73. Earlier versions of the Guide to Enactment are contained in documents A/CN.9/WG.VI/WP.66 and Add.1-4 and A/CN.9/WG.VI/WP.69 and Add.1-2.

[6] *Official Records of the General Assembly, Seventy-second Session, Supplement No. 17* (A/72/17), para. […]. The draft Guide to Enactment is contained in documents A/CN.9/914 and Add.1-6. For the earlier project of UNCITRAL on security interests (1975-1980), see http://www.uncitral.org/uncitral/uncitral_texts/security_past.html.

I. Purpose of the Guide to Enactment

1. The Guide to Enactment is intended to explain briefly the thrust of each provision of the UNCITRAL Model Law on Secured Transactions (the "Model Law") and its relationship with the corresponding recommendation(s) of the UNCITRAL Legislative Guide on Secured Transactions (the "Secured Transactions Guide")[7] and other UNCITRAL texts on secured transactions,[8] including the United Nations Convention on the Assignment of Receivables in International Trade (the "Assignment Convention"),[9] the UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (the "Intellectual Property Supplement"),[10] and the UNCITRAL Guide on the Implementation of a Security Rights Registry (the "Registry Guide").[11]

2. A number of the provisions of the Model Law indicate that a State enacting the Model Law (the "enacting State") is required to make a decision or choose among several options. The Guide to Enactment is also intended to explain the import of these decisions or choices and thus assist enacting State in making those decisions or choices.[12]

3. To better explain provisions of the Model Law while avoiding repetition, the Guide to Enactment incorporates by reference the relevant recommendations and commentary contained in the Secured Transactions Guide, the Intellectual Property Supplement and the Registry Guide. While the focus of the Guide to Enactment is mainly on giving guidance to legislators, it also includes information from the *travaux préparatoires* of the Model Law, so as to be helpful to other users of the text, such as judges, arbitrators, practitioners and academics.[13]

II. Purpose of the Model Law

4. The Model Law is designed to assist States in implementing the recommendations of the Secured Transactions Guide, as well as the Intellectual Property Supplement and the Registry Guide with respect to security rights in movable assets. The overall objective of those texts and the Model Law is to increase the availability and decrease the cost of credit by providing an efficient, modern and certain legal framework for the creation of security rights in movable assets (see Secured Transactions Guide, rec. 1 (a)). Like those texts, the Model Law is based on the assumption that, to the extent that a secured creditor is entitled to rely on the value of the encumbered asset for the payment of the secured obligation, the risk of non-payment is reduced and that result is likely to have a beneficial impact on the

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[7] United Nations publication, Sales No. E.09.V.12.

[8] *Official Records of the General Assembly, Seventieth Session, Supplement No. 17* (A/70/17), paras. 215 and 216.

[9] General Assembly resolution 56/81, annex (United Nations publication, Sales No. E.04.V.14).

[10] United Nations publication, Sales No. E.11.V.6.

[11] United Nations publication, Sales No. E.14.V.6.

[12] *Official Records of the General Assembly, Seventieth Session, Supplement No. 17* (A/70/17), para. 216.

[13] The reports of the Working Group on its work during the six sessions devoted to the preparation of the Model Law are contained in documents A/CN.9/796, A/CN.9/802, A/CN.9/830, A/CN.9/836, A/CN.9/865 and A/CN.9/871. During those sessions, the Working Group considered documents A/CN.9/WG.VI/WP.57 and Add.1 to 4, A/CN.9/WG.VI/WP.59 and Add.1, A/CN.9/WG.VI/WP.61 and Add.1 to 3, A/CN.9/WG.VI/WP.63 and Add.1 to 4, A/CN.9/WG.VI/WP.65 and Add.1 to 4, and A/CN.9/WG.VI/WP.68 and Add.1 and 2. For the reports of the Commission on its work during the two sessions it devoted to the Model Law and the document considered by the Commission during those sessions, see footnotes 1 and 3 above.

availability and the cost of credit. It should also be noted that, like those texts, the Model Law is intended to be useful to all States, whether they do not currently have efficient and effective secured transactions laws or they already have such laws but wish to modernize and harmonize them with the laws of other States that are generally consistent with the Model Law (see Secured Transactions Guide, Introduction, para. 1).

III. The Model Law as a tool for modernizing and harmonizing laws

5. In general, States that incorporate the Model Law into their national law are advised to adhere as much as possible to its uniform text. This can help assure that the enacting State will obtain the full economic benefit of the legal system envisioned by the Model Law, avoid unintended consequences that may follow when a change in one provision has unforeseen effects elsewhere in the law, and enable the enacting State to gain the benefits flowing from the harmonization of its secured transactions law with that of other States. This does not deprive enacting States of any necessary flexibility as the Model Law provides options and leaves a number of matters to enacting States.

6. Examples of flexibility in the Model Law include the following: (a) the Model Law draws the attention of the enacting State to the need to adjust certain of the terms used in the Model Law to ensure that they are meaningful in the context of local law (e.g. “authorized deposit-taking institution”, “movable property”, “immovable property” and “securities”; see art. 2, subparas. (c), (u) and (hh)); (b) several provisions of the Model Law refer within square brackets to issues that are left to the enacting State (e.g. art. 1, para. 3 (e)); (c) other provisions of the Model Law include options from which the enacting State is able to choose (e.g. art. 6, para. 3); (d) the Model Law leaves it to the enacting State to decide how to clarify in its enactment of the Model Law that that the general rules are subject to the asset-specific rules (see footnote 4); (e) the Model Law leaves it to the enacting State to decide whether to implement the Model Registry Provisions in its enactment of the Model Law, in a separate statute or in another type of legal instrument (see footnote 8); and (f) the Model Law leaves it to the enacting State to decide whether to incorporate the provisions in the conflict-of-laws provisions of the Model Law in its enactment of the Model Law or in a separate law addressing conflict-of-laws issues generally (see footnote 36).

7. The enacting State may need to make some changes to the Model Law in order to adapt it to its national legal system. Any modification, however, should not depart from the fundamental provisions of the Model Law, such as those implementing the functional, integrated and comprehensive approach to secured transactions (e.g. art. 1, para. 1, and art. 2, subpara. (kk)), the protection of the grantor and the debtor of the receivable (e.g. art. 1, paras. 5 and 6), the right of the parties to structure their security agreement as they wish to meet their needs (e.g. art. 3), the notice registration system (e.g. art. 18), the priority between a security right and the right of a competing claimant (e.g. art. 29) and the right to enforce a security right without application to a court or other authority while protecting the rights of the grantor and other parties with rights in the encumbered asset (e.g. art. 77, para. 3, and art. 78, para. 3). Otherwise, the enacting State will not be able to obtain the full economic benefits to be derived from the Model Law or achieve the harmonization of its law with the law of other States that will enact the Model Law (for the harmonization of the enactment of the Model Law with other laws of the enacting State, see para. 17 below).

8. Unlike an international convention, model legislation does not require enacting States to notify the United Nations or other enacting States. However, States are

strongly encouraged to inform the UNCITRAL secretariat of their enactment of the Model Law (or indeed any other model law resulting from the work of UNCITRAL). This information will be made available on the UNCITRAL website to publicize the fact that the enacting State has adopted an international standard and, in any case, will assist other States in their consideration of the Model Law.

IV. Main features of the Model Law

A. Relationship of the Model Law with the secured transactions texts of UNCITRAL

9. The Secured Transactions Guide, the Intellectual Property Supplement of the Secured Transactions Guide and the Registry Guide contain detailed commentary and recommendations on the issues that need to be addressed in a modern law on secured transactions. However, they are lengthy texts and States will need assistance in transforming their recommendations into concrete legislative language. The Model Law was prepared to respond to this need.

10. The Model Law reflects the policies embodied in the recommendations of these texts. Differences in formulation between those recommendations and corresponding provisions of the Model Law are generally due to the legislative nature of the Model Law and are briefly explained in the relevant parts of the Guide to Enactment.

11. For reasons explained below in the relevant parts of the Guide to Enactment, the Model Law also addresses, in a manner that is consistent with the goals and the policies of the Secured Transactions Guide and the other texts of UNCITRAL on secured transactions, matters that were not addressed in a recommendation, or even discussed in those texts (e.g. security rights in non-intermediated securities). Conversely, certain matters that were addressed in the Secured Transactions Guide are excluded from the scope of the Model Law (e.g. security rights in the right to receive the proceeds under an independent undertaking) or are not addressed specifically (e.g. security rights in attachments to encumbered movable assets or immovable property).

12. The provisions of the Model Law on security rights in receivables are substantially based on the recommendations of the Secured Transactions Guide, which in turn are based on the Assignment Convention. If a State ratifying or acceding to the Convention wishes to have an efficient and modern secured transactions law, it will nonetheless need to enact the Model Law, because: (a) the Convention applies only to security rights and outright transfers of receivables; (b) subject to limited exceptions, the Convention applies only to the assignment of international receivables and the international assignment of receivables (see art. 1, para. 1); (c) the Convention explicitly refers important matters (i.e. third-party effectiveness and priority) to the applicable domestic law, that is, the law of the assignor’s location (see art. 22); and (d) the Convention leaves other issues (e.g. the form of the assignment) to domestic law.

13. Conversely, a State enacting the Model Law will still need to ratify or accede to the Convention in order to promote effective international receivables financing. Currently, exporters often face difficulty in obtaining financing based on receivables arising from the sale of exported goods because lenders are unwilling to extend credit secured by receivables owed by customers located in States whose laws are inconsistent with modern commercial finance practice. If both the enacting State and the State where the debtors of the receivables arising from the sale of exported goods are located ratify or accede to the Convention, lenders will be more willing to extend

receivables financing to exporters because of the increased legal certainty that they will be able to collect the receivables.

B. Key objectives and fundamental policies of the Model Law

14. As already mentioned (see para. 4 above), the overall economic objective of the Model Law is the same as that of the Secured Transactions Guide (see Secured Transactions Guide rec. 1 and Introduction, paras. 43-59). The same is true for the fundamental policies of the Model Law and the Secured Transactions Guide (see Secured Transactions Guide, Introduction, paras. 60-72). One of these fundamental policies is the functional, integrated and comprehensive approach to secured transactions, under which any right created by agreement in any type of movable asset to secure the performance of an obligation is treated as a security right for the purposes of triggering the application of the Model Law, regardless of the terms used by the parties to describe their agreement (e.g. pledge, charge, transfer of title for security purposes, retention-of-title sale or financial lease; see Secured Transactions Guide, Introduction, para. 62, chap I, paras. 110-112, and chap. IX, paras. 60-84).

15. Depending on its drafting method and technique, the enacting State may wish to consider including the key objectives of the Model Law in a preamble or other similar statement accompanying its enactment of the Model Law. That statement could be used in interpreting and in filling gaps in the Model Law (see paras. 77 and 78 below).

16. The enacting State may also wish to consider producing an official commentary or guide to its enactment of the Model Law for use by courts and legal practitioners in interpreting and applying the law (see Secured Transactions Guide, Introduction, para. 86). This is likely to be particularly helpful if the Model Law introduces significant changes to the enacting State's previous secured transactions laws. Such a guide could explain the intent of particular provisions, in particular if they deviate significantly from previous law and, where necessary, provide concrete examples. Even more importantly, such an official commentary or guide could explain the fundamental principles that underlie the Model Law, such as the functional, integrated and comprehensive approach to secured transactions, under which the economic substance of a transaction, rather than its form or the wording used by the parties to describe it, determines whether secured transactions law should apply. As the Guide to Enactment discusses all these and other relevant issues (either directly or by reference to the Secured Transactions Guide), the enacting State’s commentary or guide could refer to the Guide to Enactment and the Secured Transactions Guide to allow its courts to obtain interpretative guidance from the international source from which its law was derived.

17. In enacting the Model Law, States will need to consider: (a) whether complementary amendments to other related laws (e.g. contract, property, insolvency, civil procedure and electronic commerce law) are required to ensure the overall coherence of its national law (see Secured Transactions Guide, Introduction, paras. 80-83); (b) harmonization with the existing concepts and drafting styles (see Secured Transactions Guide, Introduction, paras. 73-89); and (c) transition issues, including the preparation of an official commentary, model notice forms and agreements, the organization of educational programmes for users of the new law and the introduction of a case law reporting system (see Secured Transactions Guide, Introduction, paras. 84-89). For example, it is extremely important that the effectiveness of a security right, its priority and its enforceability is recognized in the case of the grantor’s insolvency (for the treatment of security rights in insolvency, see Secured Transactions Guide, chap. XII).

V. Assistance from the UNCITRAL secretariat

A. Assistance in drafting legislation

18. In the context of its training and assistance activities, the UNCITRAL secretariat assists States with technical consultations for the preparation of legislation based on the Model Law. The same assistance is brought to Governments considering legislation based on other UNCITRAL model laws (e.g. the UNCITRAL Model Law on Cross-Border Insolvency),[14] or considering adhesion to one of the international trade law conventions prepared by UNCITRAL (e.g. the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995)[15] and the Assignment Convention).

19. Further information concerning the Model Law and other model laws and conventions developed by UNCITRAL, may be obtained from the UNCITRAL secretariat at the address below:

International Trade Law Division, Office of Legal Affairs
United Nations
Vienna International Centre
P.O. Box 500
A-1400 Vienna, Austria
Telephone: (+43-1) 26060-4060 or 4061
Telecopy: (+43-1) 26060-5813
Electronic mail: uncitral@uncitral.org
Internet home page: www.uncitral.org

B. Information on the interpretation of legislation based on the Model Law

20. The UNCITRAL secretariat welcomes comments concerning the Model Law and the Guide to Enactment, as well as information concerning enactment of legislation based on the Model Law. Once enacted, the Model Law will be included in the CLOUT information system, which is used for collecting and disseminating information on case law relating to the conventions and model laws that have emanated from the work of UNCITRAL. The purpose of the system is to promote international awareness of the legislative texts formulated by UNCITRAL and to facilitate their uniform interpretation and application. The UNCITRAL secretariat publishes, in the six official languages of the United Nations, abstracts of decisions and arbitral awards. In addition, upon individual request and subject to any copyright and confidentiality restrictions, the UNCITRAL secretariat makes available to the public all decisions and arbitral awards on the basis of which the abstracts were prepared. The system is explained in a user's guide that is available from the UNCITRAL secretariat in hard copy (A/CN.9/SER.C/GUIDE/1/Rev.2) and on the above-mentioned Internet home page of UNCITRAL.

[14] United Nations publication, Sales No. E.14.V.2.
[15] United Nations publication, Sales No. E.97.V12.

VI. Article-by-article remarks

Chapter I. Scope of application and general provisions

Article 1. Scope of application

21. Article 1 is based on recommendations 1-7 of the Secured Transactions Guide (see chap. I, paras. 1-4, 13-15 and 101-112). It is intended to set out the various types of transaction and asset covered by the Model Law (see art. 1, paras. 1-4), as well as to clarify the relationship between the Model Law and other law (see art. 1, paras. 5 and 6). Generally, the Model Law follows the same functional, integrated and comprehensive approach to secured transactions as the Secured Transactions Guide. Thus, the Model Law applies to security rights, namely to property rights in movable assets, 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 (see art. 1, para. 1, and the definition of the term "security right" in art. 2, subpara. (kk)). However, there are some differences between the scope of the Model Law and the scope of the Secured Transactions Guide (see paras. 22-35 below).

22. Like the Secured Transactions Guide (see rec. 3) and the Assignment Convention (see art. 1, para. 1, and art. 2, subpara. (a)), the Model Law also applies to outright transfers of receivables by agreement, such as factoring (see art. 1, para. 2). The main reason for this approach is that the same third-party effectiveness and priority rules need to be applied to both outright transfers of and security rights in receivables because: (a) financing against receivables is sometimes done by an outright transfer of receivables rather than the creation of a security right in the receivables; and (b) it is sometimes difficult to determine at the outset of a transaction whether it will be held to involve an outright transfer of or the creation of a security right in a receivable (see Secured Transactions Guide, chap. I, paras. 25-31). While most modern secured transactions law generally follow this approach, some laws exclude certain types of outright transfers of receivables that are clearly not financing transactions, such as: (a) outright transfers of receivables for collection purposes where the transferee essentially acts only as an agent or trustee of the transferor; and (b) outright transfers of receivables as part of the sale of the business out of which they arose where the potential that the transfer will mislead other outright transferees or secured creditors is limited unless the old owner remains in apparent control of the business.

23. Unlike the Secured Transactions Guide which covered security rights in the right to receive payment under an independent undertaking (see rec. 2 (a)), the Model Law excludes from its scope security rights in both the right to receive and the right to request payment under an independent guarantee or letter of credit, whether commercial or standby (see art. 1, para. 3 (a)). The reason for this exclusion is that accommodating the various specialized financing practices in those areas would have made the Model Law unduly complex. Enacting States interested in dealing with security rights in those types of asset are encouraged to implement the relevant recommendations of the Secured Transactions Guide (recs. 27, 50, 107, 127, 176 and 212).

24. Like the Secured Transactions Guide (see rec. 4 (b)), to the extent that its provisions are inconsistent with law relating to intellectual property, the Model Law defers to the enacting State's law relating to intellectual property (see art. 1, para. 3 (b)). This limitation is unnecessary if the enacting State has already coordinated the Model Law and its law relating to intellectual property or plans to do so in the context of the overall reform of its secured transactions law.

25. Unlike the Secured Transactions Guide which excludes from its scope all types of securities (see rec. 4 (c)), the Model Law excludes only security rights in

non-intermediated securities (see art. 1, para. 3 (c)). The reasons for this approach are that: (a) non-intermediated securities often are part of commercial finance transactions (in which, for example, it is common for the lender's security to include in the assets to be encumbered shares of the borrower's wholly-owned subsidiaries or the shares of the borrower itself); (b) there are wide divergences among national regimes in this regard; and (c) security rights in non-intermediated securities are not addressed in any other uniform law text and thus no guidance is provided to States with regard to such securities. Conversely, security rights in intermediated securities are excluded as such securities are typically part of financial market transactions and are addressed in other uniform law texts (see Secured Transactions Guide, chap. 1, paras. 37 and 38).[16]

26. The Model Law excludes payment rights under or from financial contracts governed by netting agreements (see art. 1, para. 3 (d)), including foreign exchange transactions, because they raise complex issues that require special rules (see Secured Transactions Guide, chap. I, para. 39).

27. Combining the policy of recommendations 4 (a) and 7 of the Secured Transactions Guide, the Model Law permits the enacting State to exclude further types of asset (or transaction), provided that the matters that are addressed in the Model Law are governed by other law in force in that State (see art. 1, para. 3 (e)). The reason for this approach is to avoid inadvertently creating gaps (where that other law does not govern an issue addressed in the Model Law) or overlaps (where that other law governs an issue addressed in the Model Law).

28. Assets that may be excluded from the scope of the Model Law are, for example, assets that are subject to specialized secured transactions and registration regimes. Enacting States that do have such regimes with respect to assets that may be covered by the Model Law (e.g. ships, vehicles, aircraft or intellectual property) will have to consider whether registration with respect to security rights in those types of asset should take place in the security rights registry, in the specialized registry or in both. If registration may take place in both registries, the enacting State will have to ensure coordination of the applicable third-party effectiveness and priority rules. The Secured Transactions Guide recommends that, while a security right in an asset subject to a specialized registration system may be made effective against third parties by registration in the security rights registry, it is subordinate in priority to a security right or other right which was made effective against third parties by registration in the relevant specialized registry, irrespective of the temporal order of registration (see Secured Transactions Guide, recs. 43 and 77, subpara. (a); see also Registry Guide, paras. 23, 30 and 65).

29. The Secured Transactions Guide also recommends that, if registration in a specialized registry is possible in addition to registration in the security rights registry, an acquisition security right in consumer goods that is effective automatically (see art. 24) should not have the special priority of an acquisition security right over a security right registered in a specialized registry. The reason for this approach is to avoid any interference with any specialized registration system (see Secured Transactions Guide, chap. IX, paras. 125-128, and rec. 181).

30. The Secured Transactions Guide also discusses other ways of coordinating the security rights registry with any other registry that covers the same type of encumbered asset, including the automatic forwarding of information registered in one registry to the other registry or the implementation of common gateways to enable

[16] Such as the Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009; the "Unidroit Securities Convention") and the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary (The Hague, 2006; the "Hague Securities Convention").

registration in both registries simultaneously. However, the Secured Transactions Guide does not make any formal recommendations as to how States should ensure that registries are coordinated in the most efficient way. This approach takes into account the fact that specialized registries are typically subject to other law, and that the purposes, organization and administration of such registries vary from State to State and often from registry to registry (see Secured Transactions Guide, chap. IV, para. 117, and Registry Guide, para. 66).

31. With respect to security rights in attachments to immovable property and receivables arising from sale or lease of, or secured by, immovable property, the enacting State may wish to consider issues of coordination with immovable property registries (see Registry Guide, paras. 67-69). The enacting State may also wish to consider issues of international coordination among national security rights registries (see Registry Guide, para. 70).

32. Similarly, with respect to the application of the Model Law to proceeds, while the relevant provision of the Model Law (see art. 1, para. 4), is formulated somewhat differently from recommendation 6 of the Secured Transactions Guide, there is no policy difference between them. The policy may be explained as follows. In the case of a security right in an asset covered by the Model Law (e.g. receivables), the security right extends to its identifiable proceeds (see art. 10, para. 1); this rule applies even if the proceeds are of a type of asset that is outside the scope of the Model Law (e.g. intermediated securities), except to the extent that other law applies to proceeds of that type and governs the matters addressed in the Model Law.

33. With respect to the relationship with consumer-protection law, in line with the approach followed in the Assignment Convention (see art. 4, para. 4) and in the Secured Transactions Guide (see rec. 2 (b)), the Model Law is intended to preserve the application of consumer-protection law that protects a grantor or a debtor of an encumbered receivable (see art. 1, para. 5, of the Model Law). For example, under consumer-protection law, it may not be possible to create a security right in all present and future assets, employment benefits, at least up to a certain amount, or in necessary household items of a consumer. Enacting States that do not have a developed consumer-protection law may need to consider whether enactment of the Model Law should be accompanied by the enactment of such special protections for consumers. It should also be noted that the Model Law already includes certain consumer-specific rules (e.g. art. 24).

34. Following the approach of the Secured Transactions Guide (see rec. 18), the Model Law is intended to preserve limitations on the creation or the enforceability of a security right in certain types of asset (e.g. employment benefits) that are based on any other statutory or case law (see art. 1, para. 6). At the same time, it is intended to ensure that any such limitations based on the sole ground that an asset is a future asset, or a part of an asset or an undivided interest in an asset are overridden (see art. 8, subparas. (a) and (b)). However, paragraph 6 does not apply to contractual limitations on the creation of a security right in receivables (see art. 13) or rights to payment of funds credited to a bank account (see art. 15), or other contractual limitations such as a negative pledge agreement (for the effect of such an agreement on the creation of a security right, see para. 73 below).

35. Finally, like the Secured Transactions Guide, the general provisions of the Model Law apply to security rights in attachments to movable or immovable property, that is, movable assets that are attached to movable or immovable property, without losing their separate identity and thus becoming immovable property (see Secured Transactions Guide, Terminology). However, unlike the Secured Transactions Guide, the Model Law does not include specific provisions on security rights in attachments to movable or immovable property. Such provisions were not included in the Model

Law to avoid making it even longer. In view of the importance of attachments, enacting States are encouraged to consider whether to include in their enactments of the Model Law provisions based on the relevant recommendations of the Secured Transactions Guide (see recs. 21, 25, 43, 48, 87, 88, 164, 165, 184, 195 and 196).

Article 2. Definitions and rules of interpretation

36. Article 2 contains definitions and rules of interpretation with respect to most key terms used in the Model Law. Other terms are defined or explained in various articles of the Model Law. For example, the term "judgment creditor" is defined in article 37, paragraph 1, of the Model Law.[17] Comments are not included below on all terms but only on those that are not self-explanatory or those that are not sufficiently explained in the Secured Transactions Guide, on the terminology of which article 2 is based (see Secured Transactions Guide, Introduction, paras. 15-20).

37. The rules of interpretation of the Secured Transactions Guide also apply to the Model Law. For example: (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).

Acquisition security right

38. An acquisition security right is a security right in a tangible asset that secures the grantor's obligation with respect to credit provided to enable the grantor to acquire that tangible asset (other than intangible assets embodied in a tangible asset, such as a negotiable instrument; see art. 2, subparas. (b) and (ll)), intellectual property or the rights of a licensee in intellectual property. This definition, in conjunction with the definition of "security right", results in the rights of any lender extending credit for the acquisition of an asset, whether a general bank lender, a retention-of-title seller or a financial lessor, being treated in the Model Law as acquisition security rights. It should be noted, however, that: (a) for a security right to be an acquisition security right, the credit it secures must in fact be used for that purpose; and (b) where a security right secures both other obligations and obligations incurred for the grantor to acquire a tangible asset, that security right is an acquisition security right to the extent it secures the obligation to pay the acquisition price and a non-acquisition security right to the extent it secures those other obligations.

Bank account

39. To underline the distinction between a "bank account" and a "securities account", the Model Law defines: (a) the former term as "an account maintained by an authorized deposit-taking institution to which funds may be credited or debited" (see art. 2, subpara. (c)); (b) the latter term as "an account maintained by an intermediary to whom securities may be credited or debited" (see art. 2, subpara. (ii)); and (c) the term "securities" in a manner that clearly excludes funds (see art. 2, subpara. (hh)). The term "bank account", therefore, includes any type of bank account (e.g. current or checking and savings account). The term does not include a right against the bank to payment evidenced by a negotiable instrument. The enacting State may wish to consider replacing the term "authorized deposit-taking institution" with a generic term broad enough to include any institution authorized to receive deposits in the State whose law may be applicable under article 97 of the Model Law.

[17] Since the Model Registry Provisions may be enacted in a separate statute or other type of legal instrument, the term "registry" is defined both in article 2, subparagraph (ee) of the Model Law and article 1, subparagraph (k), of the Model Registry Provisions. If they are enacted as part of the Model Law, the latter provision will not be necessary.

Certificated non-intermediated securities

40. The term "represented" used in the definition of the term "certificated non-intermediated securities" (see art. 2, subpara. (d)) is intended to be broad enough to cover the approaches taken in different jurisdictions (e.g. "covered" or "embodied"). The term "certificate" means only a tangible document subject to physical possession. Thus, securities represented by an electronic certificate are considered to be uncertificated securities under the Model Law. It should be noted that securities represented by an electronic certificate may still qualify as non-intermediated securities.

Competing claimant

41. The term "competing claimant" is principally used in the context of a potential priority dispute between a security right and the rights of another person claiming rights in the encumbered asset (see art. 2, subpara. (e)). This term includes another creditor of the grantor (secured or not) that has a right in the asset (such as a judgement creditor that has taken certain steps to execute the judgment), a buyer or lessee of the asset and an insolvency representative in insolvency proceedings with respect of the grantor.

Consumer goods

42. Unlike the definition of the term "consumer goods" in the Secured Transactions Guide on which it is based, the definition of the term in the Model Law (see art. 2, subpara. (f)) includes the word "primarily" to ensure that: (a) goods primarily used or intended to be used for personal family or household purposes and only incidentally for business purposes would be treated as consumer goods; and (b) goods primarily used or intended to be used for business purposes and only incidentally for personal, family or household purposes would not be treated as consumer goods. Accordingly, it is the primary use or the primary intended use of tangible assets by the grantor that determines whether they will be classified as consumer goods, equipment or inventory. It should also be noted that the terms "consumer goods", "equipment" and "inventory" are primarily relevant to the articles on acquisition security rights (see paras. 46 and 50 below).

Control agreement

43. The term "control agreement" refers to an agreement between the grantor, the secured creditor and the issuer (in the case of securities) or the deposit taking institution (in the case of a right to payment of funds credited to a bank account), according to which the issuer or the deposit-taking institution agrees to follow the instructions of the secured creditor without further consent from the grantor. A control agreement can achieve three purposes: (a) to render a security right effective against third parties (see arts. 25 and 27); (b) to ensure the cooperation of the deposit-taking institution or the issuer of securities in the enforcement of a security right; and (c) to establish the priority of the secured creditor that has control. Unlike the definition of this term in the Secured Transactions Guide, on which it is based, the definition of the term in the Model Law does not refer to a "signed writing" (see art. 2, subpara. (g)). This difference does not reflect a policy change but rather a decision that this matter should be left to the evidentiary requirements of other law of the enacting State. In any case, a control agreement does not need to be in a single written document.

Default

44. The term "default" is defined in a generic way by reference to the grantor's failure to perform and to the agreement between the grantor and the secured creditor.

What exactly constitutes failure to perform (e.g. a day's or a month's delay to pay) is a matter for the agreement between the parties and the law applicable to that agreement.

Encumbered asset

45. Any movable asset to which the Model Law applies may be an encumbered asset. In order to apply the provisions of the Model Law to outright transfers of receivables by agreement, the term includes a receivable that is the subject of an outright transfer by agreement.

Equipment

46. Unlike the definition of the term "equipment" in the Secured Transactions Guide on which it is based, the definition of the term in the Model Law includes the word "primarily" to clarify that: (a) goods used or intended to be used by a person primarily in the operation of its business and only incidentally for other purposes would be treated as equipment; and (b) goods used or intended to be used by a person primarily for other purposes and only incidentally in the operation of its business would not be treated as equipment (see art. 2, subpara. (l)). This definition also includes the words "other than inventory or consumer goods" as, depending on their primary use or primary intended use, the same type of tangible assets may be "equipment", "consumer goods" or "inventory" (see art. 2, subparas. (f), (l) and (q), and paras. 42 above and 50 below).

Grantor

47. The definition of the term "grantor" makes clear that a grantor of a security right may be the debtor of the secured obligation or another person (e.g. the parent company of the debtor-subsidiary if the parent company creates a security right in its assets so that the subsidiary may borrow (see art. 2, subpara. (o) (i)). A person who is not the owner of an asset but has rights in the asset (e.g. rights under a lease agreement; see art. 2, subpara. (o) (i)) may also be a grantor of a security right in those rights. A buyer or other transferee of an encumbered asset that acquires the asset subject to a security right is also treated as a grantor, even if that person did not create a security right in the asset (see art. 2, subpara. (o) (ii)). In order to apply the provisions of the Model Law to outright transfers of receivables by agreement, the term "grantor" also includes a transferor under an outright assignment of receivables (see art. 2, subpara. (o) (iii)).

Insolvency representative

48. As the term "insolvency representative" is only used in the definition of the term "competing claimant" it is not defined in the Model Law. It is defined though in the Secured Transactions Guide (see Introduction, para. 20) and the UNCITRAL Legislative Guide on Insolvency Law (the "Insolvency Guide"; see Introduction, para. 12 (v)) in a sufficiently broad manner to include the person responsible for administering insolvency proceedings or supervising the debtor and the debtor's affairs (see Insolvency Guide, part two, chap. III, paras. 11-18 and 35). The Secured Transactions Guide and the Insolvency Guide contain definitions of other insolvency-related terms, such as the term "insolvency proceedings" (which is referred to in arts. 2, subpara. (e) (iii), 35 and 94), and the term "insolvency estate".

Intangible asset

49. The term "intangible asset" includes receivables, rights to the performance of obligations other than receivables, rights to payment of funds credited to a bank

account and uncertificated non-intermediated securities, as well as any other asset that is not a tangible asset (see art. 2, subpara. (p)).

Inventory

50. The term "inventory" refers to tangible assets held by the grantor for sale or lease in the ordinary course of the grantor's business. Thus. it is the purpose for which tangible assets are held by the grantor that determines whether they constitute inventory (see paras. 42 and 46 above). The term "work in process" includes "semi-processed materials". In States in which a licence of tangible assets is possible, the term "lease of tangible assets" in this definition includes the licence of tangible assets (see art. 2, subpara. (q)).

Mass and product

51. The Model Law distinguishes between a "mass" and a "product". A "mass" is the combination that arises when two or more tangible assets of the same type are commingled in such a way that they lose their separate identity. This could happen, for example, when a quantity of oil from one source is pumped into a storage tanker that already contains some oil from another source, or when a truckload of one farmer's wheat is put into a grain silo that already contains wheat from another farmer. In contrast, a "product" arises when one or more tangible assets are transformed into something different, through a production or manufacturing process; for example, when gold is used to make a ring, or when flour and yeast are used to make bread. The distinction is relevant to articles 11 and 33 (see paras. 97-99 below and A/CN.9/WG.VI/WP.71/Add.4, para. 15).

Money

52. The term "money" includes not only the national currency of the enacting State but also the currency of any other State (see art. 2, subpara. (t)). However, it does not include virtual currency, as virtual currency is not national currency and is intangible (and money is in principle defined as a tangible asset; see art. 2, subpara. (ll)). Currency must qualify as a legal tender to constitute money. Rights to payment of funds credited to a bank account and negotiable instruments are distinct concepts in the Model Law. They are not included in the term "money".

Movable asset

53. The enacting State may wish to ensure that this definition captures anything that its laws consider to be an asset other than immovable property (see art. 2, subpara. (u)). Depending on its legal tradition and the terminology used, the enacting State may also wish to consider whether to replace the terms "movable asset" and "immovable property" with the equivalent concepts in its law (e.g. "personal property" and "land").

Non-intermediated securities

54. The term "non-intermediated securities" refers to securities (i.e. shares and bonds) that are not credited to a securities account (see art. 2, subparas. (w) and (ii)). This definition is structured around the definition of the term "intermediated securities" in the Unidroit Securities Convention (see art. 1, subpara. (b)). It refers only to "rights", in contrast to the language used in the Unidroit Securities Convention which refers to "rights or interests", for reasons of consistency with the terminology of the Model Law in which the term "right" is a broad term that covers any right or interest. It should be noted that, if securities are held by an intermediary directly with the issuer (e.g. the intermediary is registered in the books of the issuer as the holder of

the securities), these securities in the hands of the intermediary are non-intermediated, even though equivalent securities credited by the intermediary to a securities account in the name of a customer are intermediated securities in the hands of the customer.

Notification of a security right in a receivable

55. The definition of the term "notification of a security right in a receivable" is based on the definition of the term "notification of the assignment" and recommendation 118 of the Secured Transactions Guide (see art. 2, subpara. (y)), which in turn is based on the definition of that term in the Assignment Convention (see article 5, subpara. (d)). The requirement for the identification of the encumbered receivable and the secured creditor in the definition of that term in the Assignment Convention is reflected in article 62, paragraph 1, of the Model Law as it states a substantive rule on the effectiveness of a notification of a security right, a matter that is already addressed in that article.

Possession

56. The definition of the term "possession" (see art. 2, subpara. (z)) is based on the definition of that term in the Secured Transactions Guide. The words "directly or indirectly" that were included in recommendation 28 of the Secured Transactions Guide were not included in this definition or article 16 which is based on that recommendation, because the definition is sufficiently broad to cover situations in which a person holds a tangible asset through another person (e.g. the issuer of a negotiable document may hold it through various persons responsible to perform parts of a multimodal transport contract).

Priority

57. The definition of the term "priority" (see art. 2, subpara. (aa)) is based on the definition in that term in the Secured Transactions Guide, which is in turn partly based on the definition of that term in the Assignment Convention (see art. 5, subpara. (g)). Like the definition in the Secured Transactions Guide, this definition does not include in the concept of "priority" the steps required to establish third-party effectiveness. Like the definition in the Assignment Convention and unlike the definition in the Secured Transactions Guide, however, this definition refers directly to the right of a person in preference to the right of another person.

Proceeds

58. The term "proceeds" in the Model Law (see art. 2, subpara. (bb)) has the same meaning as in the Secured Transactions Guide. It is important to note that it covers: (a) proceeds of the sale or other disposition, lease or licence of an encumbered asset (broadly understood); (b) proceeds of proceeds (e.g. if receivables are generated by the sale of encumbered inventory and those proceeds are deposited to a bank account, the right to payment of those funds constitutes proceeds of proceeds); and (c) natural fruits (e.g. the calves of the encumbered cows) or civil fruits (e.g. rents arising from the lease of encumbered assets). It should be noted that the secured creditor's right in the encumbered assets or proceeds is limited by various provisions of the Model Law. For example, under article 10, the security right extends only to identifiable proceeds; and under article 34, paragraph 4, a buyer of tangible encumbered assets in the ordinary course of the grantor's business acquires its rights in the assets free of the security right (see also arts. 19, para. 2, 34, para. 2, and 59, para. 2). It should also be noted that the terms revenues, dividends and distributions, which were included in the definition of this term in the Secured Transactions Guide, have been deleted on the understanding that they are covered by the term "civil fruits".

59. The term is not limited to proceeds received by the original grantor but includes proceeds received by a transferee of an encumbered asset when that transferee is treated as a grantor because it acquired the encumbered asset subject to the security right. For example, where A creates a security right in its assets in favour of X and then A transfers the assets to B who acquires its rights in the assets subject to X's security right and B subsequently sells the assets to C for a price of € 1.000 payable at a future date, the receivable arising from the sale by B to C constitutes proceeds covered by X's security right. The reason for this approach is that, otherwise, a transferee of an encumbered asset that acquired the asset subject to the security right (in the example, B) could sell the asset further (in the example, to C) and keep the proceeds free of the security right (for the issue of third-party transferees who are likely to search the registry under the name of their immediate transferor and who do not find a notice about a security right created by the first in a chain of transferors, see art. 26 of the Model Registry Provisions and A/CN.9/WG.VI/WP.71/Add.3, paras. 48-53).

60. It should be noted that proceeds may arise as a result of an action taken by a person other than the grantor or a transferee. Thus, article 10, paragraph 2, applies to funds in a bank account that are transferred to another bank account (even if this transfer takes place at the instigation of the deposit-taking institution) as the funds in the second bank account are "proceeds" (see para. 96 below).

Receivable

61. Like the Secured Transactions Guide, the Model Law defines the term "receivable" in a broad way to cover even non-contractual receivables, such as a claim for damages for the violation of law (see art. 2, subpara. (dd)). However, the term "receivable" does not include rights to payment evidenced by a negotiable instrument, rights to payment of funds credited to a bank account and rights to payment under a non-intermediated security, as they are treated as distinct types of asset that are subject to different asset-specific rules.

Secured creditor

62. The term "secured creditor" refers to the holder of a security right and includes a transferee in an outright transfer of a receivable by agreement (e.g. a factor in a factoring contract).

Secured obligation

63. The term "secured obligation" includes any obligation secured by a security right, including obligations arising from credit extended by a lender, a retention-of-title seller or a financial lessor (see art. 2, subpara. (gg)). It covers both monetary and non-monetary obligations, obligations already incurred at the time of the extension of the credit, as well as obligations incurred thereafter, if the security agreement so provides. As there is no secured obligation in an outright transfer of a receivable, the provisions that refer to a "secured obligation" do not apply to an outright transfer of a receivable.

Securities

64. The definition of the term "securities" in the Model Law is narrower than the definition of the term in article 1, subparagraph (a), of the Unidroit Securities Convention (see art. 2, subpara. (hh)). The reason is that, while a broad definition is appropriate for the purposes of that Convention, a broad definition for the purposes of the Model Law could result in an overlap with the terms money, receivables, negotiable instruments and other generic intangible assets and thus in uncertainty as to the regime applicable to security rights in those types of asset. In any case, the enacting State would need to coordinate the definition of the term "securities" in its

secured transactions law with the definition of the term in its law governing the transfer of securities.

Securities account

65. The definition of the term "securities account" in the Model Law is derived from article 1, subparagraph (c), of the Unidroit Securities Convention (see art. 2, subpara. (ii)). It refers to an account maintained with a securities intermediary to which securities may be credited or debited.

Security agreement

66. The term "security agreement" is defined by reference to an agreement that provides for the creation of a security right (see art. 2, subpara. (jj)). In line with the functional, integrated and comprehensive approach followed in the Model Law (see paras. 7 and 15 above), the parties need not use any special words; and even if the parties use wording that does not refer to security rights, the agreement is a security agreement if it creates by agreement a property right in a movable asset that secures the payment or other performance of an obligation (see art. 2, subpara. (kk)). Thus, transactions such as transfers of property for security purposes, retention-of-title sales, hire-purchase agreements and financial leases are treated as secured transactions. To ensure that the provisions of the Model Law apply to outright transfers of receivables, the term "security agreement" is defined so as to include an agreement for the outright transfer of receivables.

Security right

67. The term "security right" is defined by reference to a property right created by agreement to secure payment or other performance of an obligation. In line with the functional, integrated and comprehensive approach followed in the Model Law (see paras. 7, 15 and 66 above), it is irrelevant whether or not the parties have denominated the right as a security right or even that they have used wording that does not refer to a security right. To ensure that the provisions of the Model Law apply to outright transfers of receivables, the term "security right" is defined so as to include the right of the transferee under an outright transfer of a receivable by agreement.

Tangible asset

68. The term "tangible asset" in the Model Law includes money, negotiable instruments, negotiable documents and certificated non-intermediated securities (some of them being intangible rights embodied in a document) except for the purposes of certain articles that contain rules that are not appropriate for those types of asset. For example, the term "tangible asset" in the definition of the term "mass" (see in art. 2, subpara. (s)) does not include negotiable documents because negotiable documents cannot be part of a mass as they are not interchangeable with other documents and are not fungible.

Writing

69. The definition of the term "writing" is intended to ensure that where the term is referred to in the Model Law (see arts. 2 (g) and (x), 6, para. 3, 63, paras. 2 and 9, 65, paras. 1 and 2, 77, para. 2 (a), 78, para. 4 (b) and 80, paras. 1, 2 (b), 4 and 6, of the Model Law, as well as arts. 2, paras. 1-3, and 20, para. 5, of the Model Registry Provisions), this reference will include electronic communications (see art. 2, subpara. (nn)). The definition is based on recommendation 11 of the Secured Transactions Guide, which in turn is based on article 9, paragraph 2, of the United Nations Convention on the Use of Electronic Communications in International

Contracts (the "Electronic Communications Convention"). However, the Model Law does not include an article on the electronic equivalent of signature along the lines of recommendation 12 of the Secured Transactions Guide, which is in turn based on article 9, paragraph 3, of the Electronic Communications Convention. For the purpose of those articles of the Model Law that refer to signature (see arts. 6, para. 1, and 65, paras. 1 and 2), the enacting States may wish to consider whether to include in their enactment of the Model Law an article along the lines of recommendation 12 of the Secured Transactions Guide.

International obligations of the enacting State

70. The Model Law leaves to the enacting State the issue whether international treaties (such as the United Nations Convention on Contracts for the International Sale of Goods ("CISG") or the Assignment Convention when it enters into force) prevail over domestic law. For example, in the case of a conflict between a provision of the Model Law and a provision of any treaty or other form of agreement to which an enacting State is a party with one or more other States, the requirements of the treaty or agreement may prevail (see art. 3 of the UNCITRAL Model Law on Cross-Border Insolvency). Such an approach may need to be limited to international treaties that directly address matters governed by the Model Law (e.g. the creation, third-party effectiveness, priority and enforcement of a security right in movable assets). In other States, in which international treaties are not self-executing but require internal legislation in order to become enforceable law, such an approach might be inappropriate or unnecessary (see Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency, paras. 91-93).

Article 3. Party autonomy

71. Article 3 is based on article 6 of the Assignment Convention (the first sentence of which is based on art. 6 of CISG) and recommendation 10 of the Secured Transactions Guide. Paragraph 1 is intended to reflect the principle that, with the exception of the provisions listed in paragraph 1, parties are free to vary by agreement the effect of the provisions of the Model Law as between them. An agreement derogating from the provisions of the Model Law or varying its terms may be between any two parties whose rights are affected by the Model Law (e.g. between the secured creditor and the grantor, between the secured creditor and a competing claimant, between the secured creditor and the debtor of an encumbered receivable, or between the grantor and the debtor of the receivable).

72. The provisions listed in paragraph 1 are not subject to contrary agreement as permitting such an agreement with respect to these issues could result in abuse or uncertainty. In particular, article 4 sets out the general standard of conduct with which the parties have to comply with in exercising their rights and performing their obligations under the Model Law; article 6 deals with the creation of a security right and sets out the requirements for the creation of a security right; article 9 deals with the standard for the description of encumbered assets and secured obligations; articles 53 and 54 deal with obligations of the party in possession to exercise reasonable care and the obligation of the secured creditor to return the encumbered assets; and article 72, paragraph 3, deals with the variation of the rights under the enforcement provisions of the Model Law and permits variation by the grantor or the debtor only after default to avoid abuse at the time of the conclusion of the security agreement. Articles 85-87, in the chapter of conflict of laws, deal with the law applicable to property law matters; determination of the law applicable to such matters is generally not left to a choice of law by the parties to ensure certainty with regard to the law applicable to property law matters, which are bound to involve rights of third parties.

73. Paragraph 2 reiterates the general principle that an agreement between two parties cannot affect the rights of a third party. For example: (a) if there are two debtors of a receivable that is an encumbered asset, and one of the two debtors agrees, pursuant to article 65, not to raise certain defences against a secured creditor, that agreement does not bind the other debtor of the receivable; and (b) if a secured creditor agrees that the grantor may not create another security right in the same assets in favour of another creditor (negative pledge agreement), that other creditor is not bound by the negative pledge agreement. The reason for stating a general principle of contract law is that the Model Law deals with relationships in which an agreement between two parties (e.g. the grantor and the secured creditor) might otherwise appear to have an undue impact on the rights of third parties (under art. 61, there is a limited impact of an agreement between the grantor of a security right in a receivable and the secured creditor in the sense that, for example, the debtor of a receivable may have to pay a person other than the initial creditor).

74. Paragraph 3 makes clear that, if other law allows the grantor and the secured creditor to agree to resolve any dispute that may arise between them from their security agreement or a security right created by that agreement by arbitration, mediation, conciliation and online dispute resolution, nothing in the Model Law affects any agreement to use such alternate dispute resolution mechanisms. Paragraph 3 is based on the assumption that, the use of alternative dispute resolution mechanisms to resolve disputes arising between the parties from their security agreement or the security right created by that agreement is important, in particular for developing countries, to attract investment. To the extent it is inefficient, judicial enforcement is likely to have a negative impact on the availability and the cost of credit. It should be noted that paragraph 3 is intended to recognize alternative dispute resolution mechanisms, without interfering with the way in which the various legal systems deal with arbitrability of disputes arising under a security agreement or a security right, the protection of rights of third parties or access to justice.

Article 4. General standards of conduct

75. Article 4 is based on recommendation 131 of the Secured Transactions Guide (see chap. VIII, para. 15). It is included in chapter I on the scope of application and general provisions, rather than in chapter VII on enforcement, as it states standards of conduct with which parties should comply when they exercise their rights and perform their obligations under the Model Law, even outside the context of enforcement. Under article 4, any person must exercise all its rights and perform all its obligations under the Model Law in good faith and in a commercially reasonable manner. The violation of this obligation may result in liability for damages and other consequences that are left to the relevant law of the enacting State.

76. The concept of “commercial reasonableness” is not defined in the Model Law but it typically refers to actions that a reasonable person might take in circumstances that would be similar to those encountered by the grantor in a particular case. Inasmuch as there is typically no single course of action that all reasonable persons would take in a particular situation, a wide range of actions may be considered as meeting the standard of “commercial reasonableness”. It should be noted that meeting the specific standards referred to in other provisions of the Model Law (e.g. art. 78, para. 4, according to which notice is to be given within a short period of time) should generally be construed as meeting the general standards of conduct referred to in this article. It should also be noted that, article 4 is listed in article 3 as a mandatory law rule. As a result, the duty to act in good faith and in a commercially reasonable manner cannot be waived or varied by agreement.

Article 5. International origin and general principles

77. Article 5 is inspired by article 7 of the CISG and based on article 3 of the UNCITRAL Model Law on Electronic Commerce, article 4 of the UNCITRAL Model Law on Electronic Signatures and article 2A of the UNCITRAL Model Law on International Commercial Arbitration. It is intended to limit the extent to which a national law implementing the Model Law would be interpreted only by reference to concepts of the national law of the enacting State, and reference would also be made to concepts of the Model Law and laws of other States that have enacted the Model Law.

78. The Model Law is a tool not only for modernizing but also for harmonizing secured transactions laws (see paras. 5-9 above). To promote harmonization, paragraph 1 provides that the provisions of a national law implementing the Model Law should be interpreted with reference to its international origin and the observance of good faith. The term "good faith" is also used in article 4 as an obligation of persons who have rights and obligations under the Model Law. By contrast, in this article, the term identifies a consideration to be taken into account in the interpretation of the Model Law. Under paragraph 2, gaps in a law implementing the Model Law are to be filled by reference to the general principles on which the Model Law is based (see para. 15 above).

Chapter II. Creation of a security right

A. General rules

79. This chapter, and several other chapters, contain a section A with general rules and a section B with asset-specific rules. This approach is followed to avoid overloading the general rules with asset-specific details. In some cases, it can make it easier for States that conclude that they do not need all of the asset-specific rules to leave some of them out of its law. For example, an enacting State may omit the rules dealing with security rights in non-intermediated securities. However, not all asset-specific rules may be omitted. For example, some asset-specific rules deal with core commercial assets such as receivables and no enacting State should omit them from its enactment of the Model Law. The result of this approach is that the general rules apply to all assets, but, in relation to certain types of asset, they apply subject to the asset-specific rules. The enacting State may wish to consider whether to include in the general rules of each chapter of its enactment of the Model Law cross-references to the asset-specific rules in that chapter or a provision that would state explicitly that the general rules in each chapter are subject to the asset-specific rules in that chapter (see footnote 4 of the Model Law).

Article 6. Creation of a security right and requirements for a security agreement

80. Article 6 is based on recommendations 13-15 of the Secured Transactions Guide (see chap. II, paras. 12-37). Its purpose is to deal with the creation of a security right, as well as the form and the minimum content of a security agreement, so as to enable parties to obtain a security right in a simple and efficient manner (see Secured Transactions Guide, rec. 1, subpara. (c)). A security right is created by agreement, for the content of which there are no requirements other than those listed in paragraphs 3 and 4, and for the conclusion of which no terms of art or special words need be used.

81. Under paragraph 1, an agreement is sufficient to create a security right, provided that the grantor has either a right in the asset to be encumbered or the power to encumber it. The grantor has the right to encumber an asset where the grantor is the

owner of the asset. Where the grantor is in possession of the asset on the basis of an agreement with the owner, such as a lease agreement, the grantor has a right to create a security right in its rights under the lease agreement. The grantor has the power (rather than the right) to create a security right in a receivable, where the grantor has already transferred the receivable. That power is implicit in the fact that the third-party effectiveness and priority rules of the Model Law apply to outright transfers of receivables by agreement. As a practical matter, if the transferee does not make its right effective against third parties before a subsequent competing transferee or secured creditor does so, then the first transferee does not have priority over the subsequent competing transferee or secured creditor. However, if the first transferee made its right effective against third parties before the subsequent competing transferee or secured creditor, there would be no value left in the receivable for the subsequent transferee or secured creditor. It should also be noted that, in line with article 13, paragraph 1, the owner/grantor of a receivable to which that article applies has a right in the receivable or the power encumber it despite an anti-assignment agreement with the debtor of the receivable.

82. Paragraph 2 clarifies that a security agreement may provide for the creation of a security right in future assets (i.e. assets produced or acquired by the grantor after the conclusion of the security agreement; see definition in art. 2, subpara. (n)). However, the security right is created when the grantor acquires rights in them or the power to encumber them.

83. Paragraph 3 sets out the requirements for a written security agreement. From the two alternative wordings set out in the chapeau of paragraph 3 within square brackets, the enacting State may wish to select the one that is most fitting to its contract law and its law of evidence. If the enacting State retains the words “concluded in”, a security agreement that is not in written form is not effective (except as provided in art. 6, para. 4). If the enacting State retains the words “evidenced by”, a security agreement that is not in written form may still be effective if its terms are evidenced by a written document that is signed by the grantor (e.g. in a written offer by the grantor that the secured creditor accepts by way of its conduct).

84. Depending on what it considers as the most efficient financing practices and reasonable assumptions of credit market participants, the enacting State may wish to consider whether to retain paragraph 3 (d). One approach is to retain paragraph 3 (d) to facilitate the grantor’s access to secured financing from other creditors in situations where the value of the assets encumbered by the prior security right exceeds the maximum amount indicated in the notice registered with respect to that right. Another approach is to leave out paragraph 3 (d) to facilitate the grantor’s access to credit by the first secured creditor (for the comparative advantages and disadvantages of the two approaches, see Secured Transactions Guide, chap. IV, paras. 92-97, and Registry Guide, paras. 200-204). If paragraph 3 (d) is retained, the enacting State will need to make provision for the maximum amount to appear on the notice (see art. 8, subpara. (e) of the Model Registry Provisions). Otherwise the benefits of retaining paragraph 3 (d) will not be known to potential subsequent creditors (art. 24, para. 7, of the Model Registry Provisions would also need to be retained to deal with an error in stating the maximum amount on the notice).

85. Under paragraph 4, where the secured creditor is in possession of the encumbered asset on the basis of an oral security agreement with the grantor, there is no need for a written security agreement. The fact that the secured creditor is in possession of the encumbered asset is itself evidence of the existence of the security agreement (see Secured Transactions Guide, chap. II, paras. 30-33).

Article 7. Obligations that may be secured

86. Article 7 is based on recommendation 16 of the Secured Transactions Guide (see chap. II, paras. 38-48). It is primarily intended to ensure that future, conditional and fluctuating obligations may be secured. The main reason for this approach is to facilitate modern financing transactions, in the context of which an agreement may provide that disbursements of funds by the secured creditor may be made at different times depending on the needs of the grantor (e.g. revolving credit facilities for the grantor to buy inventory). This approach does not necessarily mean that grantors may not be protected from excessive economic commitments. For example, depending on the grantor's financing needs, a maximum amount may be set for which the security right may be enforced (see art. 6, para. 3 (d), and para. 84 above).

Article 8. Assets that may be encumbered

87. Article 8 is based on recommendation 17 of the Secured Transactions Guide (see chap. II, paras. 49-57 and 61-70). It is primarily intended to ensure that future movable assets, parts of movable assets and undivided rights in movable assets, generic categories of movable assets, as well as all the movable assets a person has, may be the subject of a security agreement (for the time when a security right in future assets is created, see art. 6, para. 2, and para. 82 above).

88. It should be noted that the fact that future movable assets may be subject to a security right does not mean that statutory limitations on the creation or enforcement of a security right in specific types of movable asset (e.g. employment benefits in general or up to a specific amount) are overridden (see art. 1, para. 6, and para. 34 above).

89. It should also be noted that the fact that all the movable assets a person has may be subject to a security right so as to maximize the amount of credit that may be available and improve the terms of the credit agreement does not mean that other creditors of the grantor are necessarily unprotected. The protection of other creditors (within and outside insolvency proceedings) is a matter of other law and is foreseen in articles 35 and 36 of the Model Law (see A/CN.9/WG.VI/WP.71/Add.4, paras. 23-27).

Article 9. Description of encumbered assets and secured obligations

90. Article 9 is based on recommendation 14 (d) of the Secured Transactions Guide (see chap. II, paras. 58-60). In view of its importance, the standard for the description of encumbered assets in a security agreement is presented in a separate article (rather than in art. 6, para. 3, as it was done in rec. 14 (d) of the Secured Transactions Guide, on which art. 6, para. 3, of the Model Law is based).

91. Paragraph 1 sets out the general standard that must be met in the description of encumbered assets and the secured obligations for a security agreement to be effective (the description must reasonably allow their identification). Paragraph 2 is intended to ensure that a security right may be created in an asset or class of assets even if the description in the security agreement is generic, such as "all inventory" or "all receivables" (see Secured Transactions Guide, chap. II, paras. 58-60). Paragraph 3 sets out the same standard for the description of secured obligations.

Article 10. Rights to proceeds and commingled funds

92. Article 10 is based on recommendations 19 and 20 of the Secured Transactions Guide (see chap. II, paras. 72-89). Paragraph 1 is intended to ensure that, unless otherwise agreed by the parties (as this article is not listed in article 3 as a mandatory law rule), a security right in an asset automatically extends to its identifiable proceeds (for the definition of "proceeds" see art. 2, subpara. (bb)). The rationale for this rule is

that it reflects the normal expectations of the parties and ensures that the secured creditor is sufficiently protected. This protection includes the secured creditor's right to enforce its security right both in the encumbered assets (provided that the transferee acquired its rights in the assets subject to the security right) and in the proceeds, although only up to the amount of the secured obligation. Otherwise, a grantor could effectively deprive a secured creditor of its security either by disposing of the encumbered assets to a person who would take free of the security right or to a person from whom those assets could not easily be recovered.

93. By way of example, where the original encumbered asset is inventory, receivables generated from the sale of the inventory are proceeds (if they are identifiable). If upon payment of the receivables the funds received are deposited in a bank account, the right to payment of the funds credited to the bank account is also proceeds (proceeds of proceeds of the inventory). So, too, is the right to payment pursuant to a negotiable instrument (e.g. a cheque issued by the holder of that bank account to buy new inventory), as well as a negotiable warehouse receipt issued by the warehouse in which new inventory may be stored.

94. Paragraph 2 introduces an exception to the identifiability requirement in paragraph 1. A security right in an asset extends to its proceeds in the form of funds that are commingled with other funds even though the funds that are proceeds cannot be identified separately from the funds that are not proceeds (see para. 2 (a)). Paragraph 2 (b) limits that security right to the value of the proceeds immediately before they were commingled. So, if a sum of €1,000 is deposited in a bank account and at the time of enforcement the bank account has a balance of €2,500, the security right extends only to the sum of €1,000.

95. Paragraph 2 (c) deals with situations in which the balance in the bank account fluctuates and, at some point of time, is less than the value of the proceeds deposited (in the example set out in the previous paragraph, less than €1,000). In such a case, the security right extends only to the lowest value between the time when the proceeds were commingled and the time the security right in the proceeds is claimed. So, if in the example given in the previous paragraph, the balance in the account immediately after the proceeds were deposited was €1,500, then it went down to €500 and at the time of enforcement was €750, the security right extends only to €500 (i.e. the lowest intermediate balance). The rationale for this approach is that, if the balance of a bank account falls, funds deposited later are unlikely to be proceeds of the original encumbered assets.

96. Where funds in a bank account are original encumbered assets, and the funds are transferred into another bank account and mixed with other funds in that other account, then the funds as transferred into that other account will be "proceeds" of the original funds, and thus the rules in article 10 will apply (see para. 60 above).

Article 11. Tangible assets commingled in a mass or transformed into a product

97. Article 11 is based on recommendations 22 and 91 of the Secured Transactions Guide (see chap. II, paras. 90-95 and 100-102, and chap. V, paras. 117-123). It accomplishes two related objectives. First, it transforms a security right in a tangible asset commingled in a mass or transformed into a product into a security right in the mass or product. Second, it limits the value of that security right by reference to the quantity (in the case of a mass) or the value (in the case of a product) of the tangible asset commingled in the mass or product. Article 33 then addresses situations in which more than one secured creditor has a claim to a mass or product as a result of a security right in its components (see A/CN.9/WG.VI/WP.71/Add.4, para. 15). Paragraph 1 is intended to ensure that a security right in a tangible asset that is

commingled in a mass or transformed into product will continue in the mass or product.

98. Paragraph 2 provides that a security right in a tangible asset that extends to a mass is limited to the same proportion of the mass that the asset bore to the quantity of the entire mass immediately after it was commingled in the mass. So, if a secured creditor has a security right in 100,000 litres of oil that is commingled with 50,000 litres of oil in the same tank so that the mass comprises 150,000 litres of oil, the security right is limited to two-thirds of the oil in the tank (i.e. 100,000 litres). If the quantity of the oil in the tank decreases, however, the secured creditor will still have security in two-thirds of the oil in the tank. For example, if one half of the oil leaks out so that only 75,000 litres remain, then the secured creditor will have a security right in two thirds of those 75,000 litres, namely in 50,000 litres only. The value of the security right will decrease if the value of the oil in the tank goes down and correspondingly increase if the value of the oil in the tank goes up. This reflects commercial expectations, as it puts the secured creditor in the same position that the secured creditor would have been in if the oil had not been commingled in the tank with other oil in the first place.

99. Paragraph 3 applies a slightly different rule to products, consistent with the Secured Transactions Guide (see chap. II, para. 94). If the rule in paragraph 2 were to apply to security rights in assets that are transformed into a product, then this would provide the secured creditor with a windfall gain, if the value of the finished product is greater than the value of its components (e.g. because of value that is added by the debtor's production efforts including the labour of its employees). For this reason, paragraph 3 provides instead that a security right in an asset that is transformed into a product is limited to the value of the asset immediately before it became part of the product. So, if encumbered flour worth €100 is mixed with yeast to make bread worth €500, the security right is limited to €100.

Article 12. Extinguishment of security rights

100. Article 12 deals with the extinguishment of security rights, which triggers the obligation of a secured creditor in possession to return an encumbered asset or of a secured creditor who has registered a notice of its security right to register an amendment or cancellation notice (see art. 54 of the Model Law and art. 20, para. 3 (c), of the Model Registry Provisions). Under article 12, a security right is extinguished only where there is full payment or other satisfaction of all secured obligations and there is no longer any commitment of the secured creditor to extend further credit secured by the security right. For example, if a security right secures an amount owed under a revolving credit agreement, the security right is not extinguished where temporarily there is no amount outstanding under the credit agreement, since there may still be a contingent secured exposure under the commitment of the secured creditor to extend further credit.

B. Asset-specific rules

Article 13. Contractual limitations on the creation of security rights in receivables

101. Article 13 is based on recommendation 24 of the Secured Transactions Guide (see chap. II, paras. 106-110 and 113), which in turn is based on article 9 of the Assignment Convention. Paragraph 1 provides that an agreement limiting the grantor's right to create a security right in the receivables listed in paragraph 3 (often referred to as "trade receivables") does not prevent the creation of a security right. The rationale underlying this approach is to facilitate the use of receivables as security for credit,

which is in the interest of the economy as a whole, without unduly interfering with party autonomy. This rule does not affect statutory limitations on the creation or enforcement of a security right in certain types of receivable (e.g. consumer or sovereign receivables; see art. 1, paras. 5 and 6, and paras. 33 and 34 above).

102. The agreement referred to in paragraph 1 may be entered into: (a) between the initial creditor/grantor and the debtor of the receivable; (b) where the initial creditor/grantor transfers the receivable to another person and that person creates a security right in the receivable, between that person (subsequent grantor) and the debtor of the receivable; (c) the initial creditor/grantor and the initial secured creditor; and (d) where the initial creditor/grantor transfers the asset to a person and that person creates a security right, between that person (subsequent grantor) and any secured creditor who obtained a security right from that person (subsequent secured creditor).

103. Paragraph 2 makes it clear that, while under paragraph 1 a security right is effective notwithstanding an agreement to the contrary, the grantor that creates a security right in a receivable despite that agreement (e.g. the initial creditor) is not excused from any liability to its counter-party (e.g. the debtor of the receivable) for damages caused by breach of that contractual provision, if such liability exists under other law. Thus, under paragraph 2, if a party has sufficient negotiating power to convince its counterparty to consent to an anti-assignment agreement and a breach of that agreement by the grantor results in a loss to the debtor of the receivable, the grantor may be liable to the debtor of the receivable for damages under the law of the State whose law governs that agreements. However, the debtor of the receivable may not avoid the contract because of that breach or raise against the secured creditor (assignee) by way of set off or otherwise any claim it may have against the grantor for that breach. In addition, a secured creditor that accepts a receivable as security for credit is not liable to the debtor of the receivable for the grantor's breach just because it had knowledge of the anti-assignment agreement. Otherwise, the anti-assignment agreement would in effect prevent a secured creditor from obtaining a security right in a receivable covered by the anti-assignment agreement.

104. One of the benefits of the rules in paragraphs 1 and 2 is that a secured creditor does not have to examine each contract from which a receivable might arise to determine whether it contains a contractual limitation on assignment that may affect the effectiveness of a security right. This facilitates transactions relating to pools of receivables that are not specifically identified (with respect to which a review of the underlying transactions is possible but not necessarily time- or cost-efficient), as well as transactions relating to future receivables (with respect to which such a review would not be possible at the time of the conclusion of the security agreement, with the result that future receivables could not be accepted by lenders as security for credit).

105. Paragraph 3 limits the scope of the rule in paragraph 1 to what could broadly be described as trade receivables. It does not apply to so-called "financial receivables", "because, where the debtor of the receivable is a financial institution, even partial invalidation of an anti-assignment agreement could affect obligations undertaken by the financial institution towards third parties. Such a result is likely to have negative effects on important financing transactions, such as those involving the assignment of receivables arising from or under securities or financial contracts" (see Secured Transactions Guide, chap. II, para. 108).

106. Article 13 (read together with art. 14) is intended to apply also to anti-assignment agreements limiting the creation of a security right in any personal or property rights securing or supporting payment or other performance of an encumbered intangible asset other than a receivable or an encumbered negotiable instrument.

Article 14. Personal or property rights securing or supporting payment or other performance of encumbered receivables or other intangible assets, or negotiable instruments

107. The first sentence of article 14 reflects the thrust of recommendation 25 of the Secured Transactions Guide (see chap. II, paras. 111-122), which in turn is based on article 10 of the Assignment Convention. It is intended to ensure that a secured creditor with a security right in the types of asset described in article 14 automatically has the benefit of any personal or property right that secures or supports payment or other performance of those types of asset. For example, a personal or property right that *secures* payment of a receivable may be an accessory guarantee or a security right in immovable property; and a personal right that *supports* payment of a receivable may be an independent guarantee or a stand-by letter of credit. For example, if a receivable is secured by a personal guarantee or an encumbrance on immovable property, the secured creditor with a security right in that receivable obtains the benefit of that personal guarantee or encumbrance. This means that, if the receivable is not paid, the secured creditor may seek payment from the guarantor or enforce the encumbrance in accordance with the terms of the guarantee or the encumbrance (which may require that the secured creditor register the encumbrance; see para. 108 below).

108. The first sentence of article 14 does not include recommendation 25 (h), of the Secured Transactions Guide (which was based on art. 10, para. 6, of the Assignment Convention). This is because it should be self-evident that the article does not apply to matters not addressed in it. Thus, to the extent that the automatic effects of the first sentence of article 14 are not impaired, 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 the Model Law (e.g. registration of an encumbrance on the relevant immovable property registry) is not affected.

109. The second sentence of article 14, which reflects the thrust of article 10, paragraph 1, of the Assignment Convention, is necessary because, in many States, some personal or property rights that might secure or support payment or other performance of a receivable or other intangible asset, or a negotiable instrument are transferable only with a new act of transfer. In such a case, the grantor is obliged to transfer the benefit of that right to the secured creditor. The reference in that sentence to the law governing the security or other supporting rights, is intended to ensure that other law that may require a new act of transfer is not overridden.

110. In addition, as this matter is addressed in articles 57-68, article 14 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.

Article 15. Rights to payment of funds credited to a bank account

111. Article 15 is based on recommendation 26 of the Secured Transactions Guide (see chap. II, paras. 123-125). It is intended to implement the principles underlying article 13 with respect to rights to payment of funds credited to a bank account (see para. 107 above). As a result of article 15, a security right may be created in a right to payment of funds credited to a bank account without the consent of the deposit-taking institution. However, as a result of article 69, the creation of such a security right does not affect the rights and obligations of the deposit-taking institution or obligate the deposit-taking institution to provide any information about the bank account to third parties (see A/CN.9/WG.VI/WP.71/Add.5, paras. 42-45).

Article 16. Negotiable documents and tangible assets covered by negotiable documents

112. Article 16 is based on recommendation 28 of the Secured Transactions Guide (see chap. II, para. 128). Its purpose is to follow existing law in which a negotiable document is treated as embodying rights in the tangible assets it covers. As a result, there is no need separately to create a security right in those tangible assets if there is a security right in the document (e.g. cargo covered by a negotiable document issued by the person in possession of tangible assets or agricultural products covered by a negotiable warehouse receipt issued by the operator of the warehouse in which those products have been deposited).

113. In view of the definition of the term "possession" in article 2, subparagraph (z), possession of tangible assets by the issuer of a negotiable document covering those assets includes possession by its representative or a person acting on behalf of the issuer (including in situations where the issuer is a carrier that uses other persons for the transportation of those assets on its behalf pursuant to a multi-modal transport contract). A security right in a negotiable document extends to the tangible assets covered by the document and will continue to exist (subject to the terms of the security agreement) even after the document no longer covers those assets. However, effectiveness against third parties through possession of the document applies only as long as the document covers the assets and lapses once they are released by the issuer (see art. 26, para. 2, and para. 129 below).

Article 17. Tangible assets with respect to which intellectual property is used

114. Article 17 is based on recommendation 243 of the Intellectual Property Supplement (see paras. 108-112). It is intended to recognize the distinction between a tangible asset with respect to which intellectual property is used and the intellectual property used in connection with that asset. As a result, for a secured creditor to obtain a security right in both a tangible asset with respect to which intellectual property is used (e.g. a personal computer or television set) and the intellectual property itself, the security agreement would need to expressly provide for it.

Chapter III. Effectiveness of a security right against third parties

A. General rules

Article 18. Primary methods for achieving third-party effectiveness

115. Article 18 is based on recommendation 32 of the Secured Transactions Guide (see chap. III, paras. 19-86). It is intended to set out the primary methods for achieving third-party effectiveness of a security right. The first is registration of a notice of the security right in the Registry established under article 28. This method of third-party effectiveness is available for all types of movable asset to which the Model Law applies. The second is physical possession of the encumbered asset by the secured creditor (for the definition of the term "possession", see art. 2, subpara. (z)). This latter method, as a practical matter, is available only for tangible assets. Alternative methods of third-party effectiveness for security rights in rights to payment of funds credited to a bank account and in non-intermediated securities are set out in the asset-specific provisions of this chapter (see arts. 25-27 and paras. 127 and 131 below).

Article 19. Proceeds

116. Article 19 is based on recommendations 39 and 40 of the Secured Transactions Guide (see chap. III, paras. 87-96). It addresses the circumstances in which the security right in identifiable proceeds that is provided for in article 10 is effective against third parties.

117. Under paragraph 1, if a security right in an asset is effective against third parties, a security right in its identifiable proceeds in the form of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account is automatically effective against third parties, that is, without the need for any further act. For example, upon the sale of inventory that is subject to a security right that is effective against third parties, a security right in receivables arising from the sale of the inventory that are identifiable proceeds is effective against third parties without any further act.

118. Unlike recommendation 39, on which this article is based, paragraph 1 does not refer to the description of the proceeds in the notice. This is a drafting change and does not constitute a change of policy. The reason for this change is that, if the proceeds are described in the notice (in line with the security agreement), they constitute original encumbered assets, and article 18 is sufficient in dealing with the third-party effectiveness of a security right in those assets (and, as a result, the secured creditor does not need to rely on article 19 for this matter).

119. For proceeds other than those covered in paragraph 1, paragraph 2 provides that, if a security right in an asset was effective against third parties, the security right in those types of proceeds (if they are identifiable) is effective against third parties for a short period of time that should be enough for the secured creditor to find out that proceeds have been generated and take action (such as 20-25 days); thereafter, the security right in the proceeds continues to be effective against third parties only if it is made effective against third parties before the expiry of that short time period by one of the methods set out in article 18 or the asset-specific provisions of this chapter. For example, if an encumbered motor vehicle is exchanged for another motor vehicle, the other motor vehicle constitutes proceeds to which paragraph 2 applies; and the security right in the second motor vehicle will cease to be effective against third parties if no registration is made prior to the expiry of the time period set out in paragraph 2.

120. It should be noted that time periods set out in the Guide to Enactment are suggestions (not recommendations) for the enacting State to use for its consideration of what would be appropriate for its own circumstances. It should also be noted that issues relating to the measurement of time (e.g. whether only working days are meant) are left to other law of the enacting State. However, depending on how those issues are addressed (e.g. whether holidays are to be included), the time periods suggested in the Guide to Enactment may need to be adjusted.

Article 20. Tangible assets commingled in a mass or transformed into a product

121. Article 20 is based on recommendation 44 of the Secured Transactions Guide. Its purpose is to ensure that a security right created in a tangible asset that is commingled in a mass or transformed into a product under article 11 is automatically effective against third parties, that is, no separate act is necessary to make the security right effective against third parties (for the priority of this security right, see art. 42 and A/CN.9/WG.VI/WP.71/Add.4, para. 48). It should be noted that preserving continuity of third-party effectiveness is relevant for the purposes of the priority rules.

Article 21. Changes in the method for achieving third-party effectiveness

122. Article 21 is based on recommendation 46 of the Secured Transactions Guide (see chap. III, paras. 120 and 121). It is intended to ensure that a security right made effective by one method (e.g. registration) may later be made effective by another method (e.g. a control agreement), and that third-party effectiveness is continuous as long as there is no gap between the time third-party effectiveness was achieved by the first and the second method.

Article 22. Lapses in third-party effectiveness

123. Article 22 is based on recommendation 47 of the Secured Transactions Guide (see chap. III, paras. 122-127). It is intended to ensure that, if third-party effectiveness lapses, it may be re-established. In such a case, third-party effectiveness dates only from the time it is re-established.

Article 23. Continuity in third-party effectiveness upon a change of the applicable law to this Law

124. Article 23 is based on recommendation 45 of the Secured Transactions Guide (see chap. III, paras. 117-119). Under paragraph 1, if the law enacting the Model Law becomes applicable as a result, for example, of a change in the location of the encumbered asset or the grantor, a security right that was effective against third parties under the previously applicable law continues to be effective against third parties under the law enacting the Model Law for a short period of time that should be sufficient for the secured creditor to find out that the applicable law has changed and take action (such as 45-60 days).

125. This rule does not apply if the third-party effectiveness of a security right under the initially applicable law has already lapsed or lapses during the short period of time set out in paragraph 1 (b) but before the security right is made effective against third parties within that period. Thereafter, the security right continues to be effective against third parties only if, before the expiry of that period, it is made effective against third parties under the relevant provisions of the law enacting the Model Law. Under paragraph 2, if the third-party effectiveness of a security right continues (i.e. it did not lapse and the secured creditor satisfied the requirements for third-party effectiveness before the lapse and within the short period of time set out in para. 1 (b)), it dates back to the time it was first achieved under the previously applicable law. As already mentioned (see para. 123 above), if third-party effectiveness lapses, it may be re-established, but third-party effectiveness dates from the time it is re-established.

Article 24. Acquisition security rights in consumer goods

126. Article 24 is based on recommendation 179 of the Secured Transactions Guide (see chap. IX, paras. 125-128). An acquisition security right in consumer goods is automatically effective against third parties if the purchase price of the consumer goods is below an amount to be specified by the enacting State. While this limitation is intended to exempt from registration only low-value consumer transactions, for it to be meaningful, it must be set at a reasonably high price (for the question whether a buyer acquires its rights free of an acquisition security right that is automatically effective against third parties, see art. 34, para. 9, and A/CN.9/WG.VI/WP.71/Add.4, para. 21). That price should not be so high as to prevent a consumer from encumbering his or her assets to obtain credit, but not too low either to make it necessary for a secured creditor to register a notice of its security right. For example, the price could be several times the cost of registration or amount to the cost of typical durable

household goods, or could be set at a level that would not justify the cost of enforcement of a security right.

B. Asset-specific rules

Article 25. Rights to payment of funds credited to a bank account

127. Article 25 is based on recommendation 49 of the Secured Transactions Guide (see chap. III, paras. 138-148). It adds to the methods set out in article 18 three asset-specific methods of achieving the third-party effectiveness of a security right in a right to payment of funds credited to a bank account. First, if the secured creditor is the deposit-taking institution with which the account is held, no additional action is required for a security right to become effective against third parties. Second, the security right is effective against third parties upon conclusion of a control agreement among the grantor, the secured creditor and the deposit-taking institution (for the definition of the term "control agreement", see art. 2, subpara. (g) (ii)). Third, the security right is effective against third parties if the secured creditor becomes the account holder. The precise action required for the secured creditor to become the account holder depends on the relevant law of the enacting State.

Article 26. Negotiable documents and tangible assets covered by negotiable documents

128. Article 26 is based on recommendations 51-53 of the Secured Transactions Guide (see chap. III, paras. 154-158). It addresses the relationship between the third-party effectiveness of a security right in a negotiable document and the third-party effectiveness of a security right in the tangible assets covered by the document.

129. Under paragraph 1, if a security right in a negotiable document (which extends to the assets covered by the document under article 16) is effective against third parties, the security right in the assets covered by the document is also effective against third parties for as long as the assets are covered by the document. Under paragraph 2, possession of the document is sufficient to make the security right in the assets covered by the document effective against third parties.

130. Under paragraph 3, the security right in an asset 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 (such as 5 days) after the secured creditor relinquishes the possession of the document or the assets covered by the document for the purpose of enabling the grantor to deal with those assets. In paragraph 3, the words "or the asset covered by the document", which did not appear in recommendation 53, were added for clarification as to what would happen in actual practice; and the words "physical actions like loading and unloading", which appeared in that recommendation, were deleted on the understanding that the words "dealing with the asset" are sufficiently broad to cover not only transactions like sale and exchange but also physical actions like loading and unloading.

Article 27. Uncertificated non-intermediated securities

131. Article 27 is a new provision that does not correspond to any of the recommendations of the Secured Transactions Guide, which did not apply to security rights in any type of securities (see rec. 4 (c)). It addresses the methods, other than registration of a notice, by which a security right in uncertificated non-intermediated securities may be made effective against third parties. First, the security right may be made effective against third parties by notation of the security right or entry of the name of the secured creditor as the holder of the securities in the books maintained by

the issuer or by another person on behalf of the issuer for the purpose of recording the name of the holder of securities (the enacting State should choose the method that would be best in line with its legal system; and if both methods are used in an enacting State, that State may choose to retain them both). Second, as in the case of a security right in a right to payment of funds credited to a bank account, the conclusion of a control agreement (between the grantor, the secured creditor and the issuer) with respect to the encumbered securities will result in the security right in those securities being effective against third parties.

Additional third-party effectiveness method for negotiable instruments and non-intermediated securities

132. Under article 19 of the Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes (Geneva, 1930; the "Geneva Uniform Law"), "when an endorsement contains the statements 'value in security' ('valeur en garantie'), 'value in pledge' ('valeur en gage'), or any other statement implying a pledge, the holder may exercise all the rights arising out of the bill of exchange, but an endorsement by him has the effects only of an endorsement by an agent". Article 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes (the "Bills and Notes Convention") contains a similar rule, according to which "if an endorsement contain the words "value in security, or any other words indicating a pledge, the endorsee is a holder who: (a) may exercise all rights arising out of the instrument …".

133. An enacting State that has enacted the Geneva Uniform Law (or the Bills and Notes Convention) may wish to include: (a) this rule in its enactment of the Model Law (as a rule of creation and/or third-party effectiveness of a security right in negotiable instruments and non-intermediated securities); and (b) a rule dealing with the comparative priority of such a security right. Another option would be to leave the matter to articles 46, paragraph 2, 49, paragraph 3, and 51, paragraph 5, under which such a holder of a negotiable instrument or a non-intermediated security would take its rights free of, or unaffected by, any security right. A further option would be to leave the matter to the relevant domestic law rule dealing with the hierarchy between domestic law and an international convention (see para. 70 above).