United Nations A/CN.9/637

General Assembly

Distr.: General
27 August 2007

Original: English

INFORMAL DRAFT FOR DISCUSSION ONLY; This is a tentative discussion draft; it not an official draft

United Nations Commission on International Trade Law
Fortieth session, second part
Vienna, 10-14 December 2007

Security interests

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

Note by the Secretariat

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Terminology

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

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

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

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

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

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

(e) "Assignment" means the creation of a security right in a receivable and includes an outright transfer of a receivable (see definition of the term "security right");

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

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

(h) "Attachment to movable property" means a tangible asset that is so physically attached to another tangible asset that, despite the fact that it has not lost its separate identity, it is treated as movable property under other law;

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

The right to payment of funds credited to a bank account covers a right to the payment of funds transferred into an internal account of the bank and not applied to any obligations owed to the bank. Funds transferred to the bank by way of anticipated reimbursement of a future payment obligation that the bank has accepted

in the ordinary course of its banking business is also covered to the extent that the person that gave the bank instructions has a claim to those funds if the bank does not make the future payment;

(j) "Competing claimant" means:

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

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

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

(iv) The insolvency representative in the insolvency of the grantor (in the chapter on insolvency, reference is made to "the insolvency of the debtor" for reasons of consistency with the terminology used in the *UNCITRAL Legislative Guide on Insolvency Law*); or

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

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

In line with article 6, subparagraph (e), of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit[2] (the "United Nations Guarantee and Stand-by Convention"), a confirmation provides the beneficiary with the option of demanding payment from the confirmer in conformity with the terms and conditions of the confirmed independent undertaking instead of from the guarantor/issuer;

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

(m) "Control" with respect to proceeds under an independent undertaking exists:

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

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

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

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

(ii) If the depositary bank has concluded a control agreement with the grantor and the secured creditor evidenced by a signed writing (for the meaning of the term "signed writing" in the context of electronic

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

communications, see recommendations 9 and 10) according to which the depositary bank has agreed to follow instructions from the secured creditor with respect to the payment of funds credited to the bank account without further consent from the grantor; or

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

There is no obligation on a depositary bank to enter into a control agreement. In addition, a secured creditor's rights will be subject to the rights and obligations of the depositary bank under law and practice governing bank accounts. Moreover, a control agreement requires the consent of the grantor (as well as of the depositary bank). The grantor retains the right to deal with the funds in the bank account until the secured creditor instructs the depositary bank otherwise (although in some control agreements, the funds would be blocked from the time of the conclusion of the control agreement). This covers situations where (a) an existing account is transferred to the secured creditor; (b) the secured creditor agrees with the grantor that funds should be deposited to an account to be opened later; and (c) the secured creditor is the sole account holder (rather than a joint account holder);

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

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

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

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

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

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

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

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

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

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

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

(u) "Grantor" means a person that creates a security right to secure either its own obligation or that of another person (see the definition of the term "debtor"). Under the unitary approach, the term "grantor" of an acquisition security right includes a retention-of-title buyer or financial lessee. Because, with respect to receivables, a security right includes the right of the assignee, unless otherwise provided, references to the "grantor" also refer to the "assignor" (see the definition of the term "debtor");

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

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

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

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

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

(aa) "Insolvency representative" means a person or body authorized in insolvency proceedings to administer the reorganization or the liquidation of the insolvency estate;

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

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

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

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

(ff) "Knowledge" means actual rather than constructive knowledge;

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

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

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

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

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

(iii) The set-off of amounts calculated as set forth in subparagraph (l) (ii) of this article under two or more netting agreements; “Negotiable document” means a document, such as a warehouse receipt or a bill of lading, that embodies a right to delivery of tangible assets and satisfies the requirements for negotiability under the law governing negotiable documents;

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

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

(ll) “Non-possessory security right” means a security right in (i) a tangible asset that is not in the actual possession of the secured creditor or of another person holding the asset for the benefit of the secured creditor, or (ii) intangible property;

(mm)“Notice” means a communication in writing;

(nn) “Notification of the assignment” means a communication in writing that reasonably identifies the assigned receivable and the assignee;

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

(pp) “Possession” (except as the term is used in recommendations 29 and 52-54 with respect to the issuer of a negotiable document) means the actual possession of a tangible asset by a person or an agent or employee of that person, or by an independent person that acknowledges that it holds for that person. It does not include constructive, fictive, deemed or symbolic possession;

(qq) "Possessory security right" means a security right in a tangible asset that is in the actual possession of the secured creditor or of another person (other than the debtor or other grantor) holding the asset for the benefit of the secured creditor;

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

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

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

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

(ii) What is received upon honour of an independent undertaking or upon disposition of proceeds under an independent undertaking (i.e. the proceeds derived from collection or disposition of the proceeds under an independent undertaking).

This definition refers to "proceeds under an independent undertaking" to be consistent with terminology generally used in independent undertaking law and practice. The term as used in the Guide means the right of the grantor as beneficiary of an independent undertaking to receive whatever payment or other value is given under the independent undertaking contingent upon the beneficiary making a presentation complying with the terms and conditions of the independent undertaking. The term does not include the proceeds themselves, i.e. what is actually received upon honour of a draw by the guarantor/issuer, confirmer or nominated person (a beneficiary's receipt of value from a negotiating bank should not be characterized as honour or disposition) or upon disposition of a right to proceeds under an independent undertaking.

The term "proceeds under an independent undertaking" refers to a right to receive even though the term "proceeds" as used in independent undertaking law and practice may refer either to the right to receive or to whatever is received under the independent undertaking, and even though the term "proceeds" as used elsewhere in the Guide refers to whatever is received. A security right in proceeds under an independent undertaking (as an original encumbered asset) is different from a security right in "proceeds" (a key concept of the Guide) of assets covered in the Guide;

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

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

(ww) "Secured creditor" means a creditor that has a security right. With respect to a receivable, the term means the "assignee" of the receivable (see the definition of the term "assignment");

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

(yy) "Secured transaction" means a transaction that creates a proprietary (as opposed to personal) security right in movable property (as opposed to immovable property);

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

(aaa) "Security right" means a property right in movable assets and attachments that is created by agreement and secures payment or other performance of one or more obligations, regardless of whether the parties have denominated it as a security right. In the context of the unitary approach to acquisition financing, the term includes both acquisition security rights and non-acquisition security rights, but in the context of the non-unitary approach to acquisition financing, it does not include a retention-of-title or financial lease right. With respect to receivables, security right also means the right of the assignee (see the definition of "assignment" and other definitions below relating to assignments of receivables);

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

(ccc) "Tangible asset " means all forms of corporeal movable assets. Among the categories of tangible assets are inventory, equipment, attachments, negotiable instruments, negotiable documents and money.

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

Purpose

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

Key objectives

1. The law should be designed:

(a) To promote secured credit;

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

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

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

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

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

(g) To establish clear and predictable priority rules;

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

(i) To balance the interests of affected persons;

(j) To recognize party autonomy; and

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

II. Scope of application and other general rules

Purpose

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

Assets, parties, obligations and security and other rights

2. Subject to recommendations 3-7, the law should apply to:

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

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

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

(d) All types of security right in movable property;

(e) All types of property right created contractually to secure the payment or other performance of an obligation, irrespective of the form of the relevant transaction, including transfers of title to tangible assets or assignments of receivables for security purposes, the various forms of retention-of-title sales, financial leases and hire-purchase agreements.

Outright transfers of receivables

3. The law should apply to outright transfers of receivables as provided in recommendation 162.

Aircraft, railway rolling stock, space objects, ships, intellectual property, securities, financial contracts and foreign exchange contracts

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

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

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

(c) Securities; and

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

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

Immovable property

5. The law should provide that, although it may affect immovable property, as provided in recommendations 26 and 49, it does not apply to immovable property.

Proceeds of excluded types of asset

6. The law should provide that law other than this law determines whether a security right in excluded types of asset (e.g. immovable property) confers a security right in types of proceeds to which the law applies (e.g. receivables). If, under that other law, there is a security right in types of proceeds to which the law applies, the law applies to that security right except to the extent that that other law applies to [the third-party effectiveness, priority or enforcement of that security right] [that security right].

Other exceptions

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

Party autonomy

8. The law should provide that, except as otherwise provided in recommendations 14, 109, 129-132, 184-196 and 198-207, the secured creditor and the grantor or the debtor may derogate from or vary by agreement its provisions relating to their respective rights and obligations. Such an agreement does not affect the rights of any person that is not a party to the agreement.

Electronic communications

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

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

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

(b) The method used is either:

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

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

[*Note to the Commission: The Commission may wish to note that recommendations 9 and 10 are based on article 9, paragraphs 2 and 3, of the United Nations Convention on the Use of Electronic Communications in International Contracts.*]

III. Basic approaches to security

Purpose

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

Integrated and functional approach

11. The law should establish an integrated and consistent set of provisions on security rights in tangible and intangible assets. Its provisions should apply to all contractually created rights (regardless of form) in movable property that secure an obligation, including rights under a transfer of title to tangible assets or an assignment of receivables for security purposes, the various forms of a retention-of-title sale, a financial lease or a hire-purchase agreement. [The provisions of the law apply to security rights that are extended in proceeds by operation of this law. The priority provisions of the law apply to rights arising by operation of law (e.g. preferential claims) or from a court judgement.]

[*Note to the Commission: The Commission may wish to consider whether the text in square brackets should be retained. It is intended to clarify that the law may have an impact on rights that are not created contractually.*] **[Consider whether the bracketed text and the note should be moved to rec. 2 or so.]**

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

Purpose

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

A. General recommendations

Creation of a security right

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

Essential elements of a security agreement

13. The law should provide that, for a security agreement to be effective, it must reflect the intent of the parties to create a security right, identify the secured creditor and the grantor, and describe the secured obligation and the encumbered assets. A

generic description of the encumbered assets is sufficient (e.g. "all present and future assets" or "all present and future inventory").

Form of the security agreement

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

Obligations subject to a security agreement

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

Assets subject to a security agreement

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

17. The law should provide that, except as provided in recommendations 24-26, it does not override provisions of any other law to the extent that they limit the creation or enforcement of a security right in, or the transferability of, specific types of asset.

Creation of a security right in proceeds

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

Commingled proceeds

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

20. The law should provide that, where proceeds other than money or funds credited to a bank account have been commingled with other assets of the same kind so that the proceeds are not identifiable, the share of the total asset that the value of the proceeds bears to the total value of the asset, is to be treated as identifiable proceeds.

Tangible assets commingled in a mass or product

21. The law should provide that recommendations 19 and 20 apply also to tangible assets commingled in a mass or product.

Creation of a security right in an attachment

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

Creation of a security right in a mass or product

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

B. Asset-specific recommendations

[*Note to the Commission: The Commission may wish to note that recommendations 24-26 are based on articles 8-10 of the United Nations Convention on the Assignment of Receivables in International Trade (hereinafter referred to as "the United Nations Assignment Convention"*.]

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

24. The law should provide that:

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

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

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

25. The law should provide that:

(a) An assignment of a receivable is effective as between the assignor and the assignee and as against the debtor of the receivable notwithstanding an agreement between the initial or any subsequent assignor and the debtor of the

receivable or any subsequent assignee limiting in any way the assignor's right to assign its receivables;

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

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

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

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

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

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

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

26. The law should provide that:

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

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

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

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

(e) Nothing in this recommendation affects any obligation or liability of the grantor for breach of the agreement mentioned in subparagraph (d) of this

recommendation, but the other party to such an agreement may not avoid the contract from which the receivable, negotiable instrument or other intangible asset arises, or the security agreement creating the personal or property security right on the sole ground of that breach. A person that is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement;

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

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

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

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

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

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

(h) To the extent that the automatic effects under subparagraph (a) of this recommendation and recommendation 49 are not impaired, this recommendation does not affect any requirement under law other than this law relating to the form or registration of the creation of a security right in any asset, securing payment or other performance of a receivable, negotiable instrument or other obligation, that is not covered by this law.

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

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

Creation of a security right in proceeds under an independent undertaking

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

Creation of a security right in a negotiable document or goods covered by a negotiable document

29. The law should provide that a security right in a negotiable document extends to the goods covered by the document, provided that the issuer is in possession of the goods, directly or indirectly, at the time the security right in the document is created.

V. Effectiveness of a security right against third parties

Purpose

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

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

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

A. General recommendations

Meaning of third-party effectiveness

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

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

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

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

32. The law should provide that, after transfer of a right other than a security right in an encumbered asset, a security right in the encumbered asset that is effective against third parties at the time of the transfer continues to encumber the asset except as provided in recommendations 85-87, and remains effective against third parties except as provided in recommendation 62.

[*Note to the Commission: The Commission may wish to note that recommendations 33-37 are not intended to state the relevant rules but rather to list, for the ease of the reader, the various methods for achieving third-party effectiveness and to refer to the following recommendations that state the relevant rules.*]

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

33. The law should provide that a security right created in accordance with the provisions of the law on creation is effective against third parties if a notice with respect to the security right is registered in the general security rights registry referred to in recommendations 55-73.

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

Alternatives and exceptions to registration for achieving third-party effectiveness of a security right

35. The law should provide that:

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

(i) In tangible assets, by transfer of possession, as provided in recommendation 38;

(ii) In goods covered by a negotiable document, by transfer of possession of the document, as provided in recommendations 52-54;

(iii) In movable property subject to registration in a specialized registry or notation on a title certificate, by such registration or notation, as provided in recommendation 39;

(iv) In a right to payment of funds credited to a bank account, by control, as provided in recommendation 50; and

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

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

(i) In proceeds, if the security right in the original encumbered assets is effective against third parties, as provided in recommendations 40 and 41;

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

(iii) In a mass or product, if the security right in the separate movable property is effective against third parties before it becomes part of the mass or product, as provided in recommendation 45; and

(iv) In movable property, upon a change in the location of the property or the grantor to this State, as provided in recommendation 46; and

(c) A security right in a personal or property right securing payment or other performance of a receivable, negotiable instrument or other intangible asset obligation is effective against third parties, as provided in recommendation 49.

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

36. The law should provide that, except as provided in recommendation 49, a security right in proceeds under an independent undertaking is made effective against third parties only by control, as provided in recommendation 51.

Different third-party effectiveness methods for different types of asset

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

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

38. The law should provide that a security right in tangible assets may be made effective against third parties by registration as provided in recommendation 33 or through transfer of possession to the secured creditor.

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

39. The law should provide that a security right in movable property that is subject to registration in a specialized registry or notation on a title certificate under law other than this law may be made effective against third parties by registration as provided in recommendation 33 or by:

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

Automatic third-party effectiveness of a security right in proceeds

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

41. If recommendation 40 does not apply, the security right in the proceeds is effective against third parties for [to be specified] days after the proceeds arise and continuously thereafter, if it was made effective against third parties by one of the methods referred to in recommendation 33 or 35 before the expiry of that time period.

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

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

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

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

(a) Registration in the specialized registry; or

(b) Notation on the title certificate.

44. The law should provide that a security right in an attachment to immovable property may be made effective against third parties automatically as provided in recommendation 42 or by registration in the immovable property registry.

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

45. The law should provide that, if a security right in a tangible asset is effective against third parties when it becomes part of a mass or product, the security right that continues in the mass or product, as provided in recommendation 23, is effective against third parties.

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

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

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

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

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

48. The law should provide that, if a security right has been made effective against third parties and subsequently there is a period during which the security right is not effective against third parties, third-party effectiveness may be re-established. In such a case, third-party effectiveness takes effect from the time thereafter when the security right is made effective against third parties. Similarly, if registration made before creation of a security right as provided in recommendation 65 expires as provided in recommendation 67, it may be re-established. In such a case, registration takes effect from the time thereafter when a notice with respect to the security right is registered.

B. Asset-specific recommendations

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

49. The law should provide that, if a security right in a receivable, negotiable instrument or any other intangible asset covered by this law is effective against third parties, such third-party effectiveness extends to any personal or property right that secures payment or other performance of the receivable, negotiable instrument or other intangible asset, without further action by either the grantor or the secured creditor. If the personal or property right is an independent undertaking, its third-party effectiveness automatically extends to the proceeds under the independent undertaking (but, as provided in recommendation 26, subparagraph (b), the security right does not extend to the right to draw under the independent undertaking). This recommendation does not affect a right in immovable property that under law other than this law is transferable separately from a receivable, negotiable instrument or other intangible asset that it may secure.

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

50. The law should provide that a security right in a right to payment of funds credited to a bank account may be made effective against third parties by registration as provided in recommendation 33 or by the secured creditor obtaining control with respect to the right to payment of funds credited to the bank account.

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

51. The law should provide that, except as provided in recommendation 49, a security right in proceeds under an independent undertaking may be made effective against third parties only by the secured creditor obtaining control with respect to the proceeds under the independent undertaking.

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

52. The law should provide that a security right in a negotiable document may be made effective against third parties by registration as provided in recommendation 33 or by the secured creditor obtaining possession of the document.

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

54. The law should provide that a security right in a negotiable document that was made effective against third parties by the secured creditor obtaining possession of the document remains effective against third parties for a short period of [to be specified] days after the negotiable document has been relinquished to the grantor or other person for the purpose of ultimate sale or exchange, loading or unloading, or otherwise dealing with the goods covered by the negotiable document.

VI. The registry system

Purpose

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

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

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

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

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

Operational framework of the registration and searching processes

55. The law should provide a framework to ensure that the registration and searching processes operate as follows:

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

(b) Registration is effected by registering a notice that provides the information specified in recommendation 58, as opposed to requiring the submission of the original or a copy of the security agreement or other document;

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

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

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

(iii) It fails to provide some information with respect to any of the other items required under recommendation 58;

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

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

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

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

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

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

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

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

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

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

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

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

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

Security and integrity of the registry

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

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

(b) The identity of a registrant is requested and maintained by the registry (as to verification of the registrant's identity, see recommendation 55, subparagraph (d));

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

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

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

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

Responsibility for loss or damage

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

Required content of notice

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

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

(b) A description of the asset covered by the notice, satisfying the standard provided in recommendation 64;

(c) The duration of the registration as provided in recommendation 67; and

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

Sufficiency of grantor identifier

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

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

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

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

62. The law should provide that, if, after a notice is registered, the identifier of the grantor used in the notice changes and as a result the grantor's identifier does not meet the standard provided in recommendations 59-61, the secured creditor may amend the registered notice to provide the new identifier in compliance with that standard. If the secured creditor does not register the amendment within [to be specified] days after the change, the security right is ineffective against:

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

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

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

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

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

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

Sufficiency of description of assets covered by a notice

64. The law should provide that a description of the assets covered by a notice is sufficient if it reasonably describes the assets covered by the notice. A generic description of the encumbered assets, as provided in recommendation 13, is sufficient.

Time of registration

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

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

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

Duration and extension of the registration of a notice

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

Time of effectiveness of registration of a notice or amendment

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

Authority for registration

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

Cancellation or amendment of notice

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

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

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

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

[*Note to the Commission: The Commission may wish to add a recommendation addressing the right of the secured creditor to amend the notice, for example to change its address or name, or the description of the encumbered asset.*]

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

72. The law should provide that promptly after a registered notice has expired as provided in recommendation 67 or has been cancelled as provided in recommendation 70 or 71, the information contained in the notice should be removed from the records of the registry, which are accessible to the public. However, the information provided in the expired or cancelled or amended notice and the fact of expiration or cancellation or amendment should be archived so as to be capable of retrieval if necessary.

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

VII. Priority of a security right

Purpose

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

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

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

A. General recommendations

Extent of priority

74. The law should provide that the priority of a security right extends to all obligations secured under the security agreement. If a State implements recommendation 58, subparagraph (d), the priority of the security right is limited to the maximum amount set out in the registered notice.

Irrelevance of knowledge of the existence of the security right

75. The law should provide that knowledge of the existence of a security right on the part of a competing claimant does not affect priority (as for the impact of knowledge that a transaction violates the rights of a secured creditor, see recommendations 87, 100, subparagraph (b), 103 and 104).

Priority of security rights securing future obligations

76. The law should provide that, subject to recommendation 90, the priority of a security right does not depend on the time when the secured obligation was incurred.

Subordination

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

Priority between security rights in the same encumbered assets

78. The law should provide that, except as provided in recommendations 83, 84, 93-107, 174-176, and 178-193 **[the non-unitary approach recs. do not use the term priority-how should we refer to them?]**, priority between competing security rights in the same encumbered assets is determined as follows:

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

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

(c) As between a security right that was made effective against third parties by registration and a security right that was made effective against third parties otherwise than by registration, priority is determined by the order of registration (regardless of when creation occurs) and third-party effectiveness, whichever occurs first.

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

79. The law should provide that, for purposes of recommendation 78, subparagraphs (a) and (c),the priority of a security right extends to all encumbered assets covered by the registered notice, irrespective of whether they are acquired by the grantor or come into existence before, at or after the time of registration.

Application of priority rules to a security right in proceeds

80. The law should provide that, for purposes of recommendation 78, the time of third-party effectiveness or the time of registration of a notice as to a security right in an encumbered asset is also the time of third-party effectiveness or registration as to a security right in its proceeds.

Continuity in priority

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

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

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

83. The law should provide that a security right in an asset that is made effective against third parties by registration in a specialized registry or notation on a title certificate, as provided in recommendation 39, has priority as against:

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

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

84. The law should provide that, if an encumbered asset is transferred, leased or licensed and, at the time of transfer, lease or licence, a security right in that asset is effective against third parties by registration in a specialized registry or notation on a title certificate, as provided in recommendation 39, the transferee, lessee or licensee takes its rights subject to the security right, except as provided in recommendations 86-88. However, if the security right has not been made effective against third parties by registration in a specialized registry or notation on a title certificate, a transferee, lessee or licensee takes its rights free of the security right.

Rights of transferees, lessees and licensees of an encumbered asset

85. The law should provide that, if an encumbered asset is transferred, leased or licensed and a security right in that asset is effective against third parties at the time of the transfer, lease or licence, a transferee, lessee or licensee takes its rights subject to the security right except as provided in recommendations 84 and 86-88.

86. The law should provide that:

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

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

87. The law should provide that:

(a) A buyer of a tangible asset (other than a negotiable instrument or negotiable document) sold in the ordinary course of the seller's business that does not have knowledge that the sale violates the rights of a secured creditor under a security agreement takes free of the security right;

(b) The rights of a lessee of a tangible asset (other than a negotiable instrument or document) leased in the ordinary course of the lessor's business without knowledge that the lease violates the rights of a secured creditor under a security agreement are not affected by the security right; and

(c) The rights of a non-exclusive licensee of an intangible asset licensed in the ordinary course of the licensor's business without knowledge that the licence violates the rights of a secured creditor under a security agreement are not affected by the security right.

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

Priority of preferential claims

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

Priority of rights of judgement creditors

90. The law should provide that, except as provided in recommendation 194 (unitary approach), a security right has priority as against the rights of an unsecured creditor, unless the unsecured creditor, under other law, obtained a judgement or provisional court order against the grantor and took the steps necessary to acquire rights in assets of the grantor by reason of the judgement or provisional court order before the security right was made effective against third parties. The priority of the security right extends to credit extended by the secured creditor:

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

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

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

91. The law should provide that, if other law gives rights equivalent to security rights to a creditor that has provided services with respect to an encumbered asset (e.g. by repairing, storing or transporting it), such rights are limited to the asset in the possession of that creditor up to the reasonable value of the services rendered and have priority as against pre-existing security rights in the asset.

Priority of a supplier's reclamation right

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

Priority of a security right in an attachment

93. The law should provide that a security right or any other right (such as the right of a buyer or lessee) in an attachment to immovable property that is created and made effective against third parties under immovable property law, as provided in recommendations 22 and 44, has priority as against a security right in that attachment that is made effective against third parties by one of the methods referred to in recommendation 33 or 35.

94. The law should provide that a security right in a tangible asset that is an attachment to immovable property at the time the security right is made effective against third parties or that becomes an attachment to immovable property subsequently and that is made effective against third parties by registration in the immovable property registry as provided in recommendation 44, has priority as against a security right or any other right (such as the right of a buyer or lessor) in the related immovable property that is registered subsequently.

95. A security right or any other right (such as the right of a buyer or lessee) in an attachment to movable property that is made effective against third parties by registration in a specialized registry or by notation on a title certificate under recommendation 43, has priority as against a security right or other right in the related movable property that is registered subsequently.

Priority of a security right in a mass or product

96. The law should provide that, if two or more security rights in the same tangible asset continue in a mass or product as provided in recommendation 23, they retain the same priority as the security rights in the asset had as against each other immediately before the asset became part of the mass or product.

97. The law should provide that, if security rights in separate tangible assets continue in the same mass or product and each security right is effective against third parties, the secured creditors are entitled to share in the aggregate maximum value of their security rights in the mass or product according to the ratio of the value of the respective security rights. For purposes of this formula, the maximum value of a security right is the lesser of the value determined pursuant to recommendation 23 and the amount of the secured obligation.

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

B. Asset-specific recommendations

Priority of a security right in a negotiable instrument

99. The law should provide that a security right in a negotiable instrument that is made effective against third parties by possession of the instrument, as provided in recommendation 38, has priority as against a security right in a negotiable instrument that is made effective against third parties by any other method.

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

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

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

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

101. The law should provide that a security right in a right to payment of funds credited to a bank account that is made effective against third parties by control, as provided in recommendation 50, has priority as against a competing security right that is made effective against third parties by any other method. If a depositary bank concludes control agreements with more than one secured creditor, priority among those secured creditors is determined according to the order in which the control agreements are concluded. If the depositary bank is the secured creditor, its security right has priority as against any other security right (including a security right made effective against third parties by a control agreement with the depositary bank even if the depositary bank's security right is later in time) except a security right of a secured creditor that obtains control by becoming the account holder.

102. The law should provide that a right under other law of a depositary bank to set off obligations owed to the depositary bank by the grantor against the grantor's right to payment of funds credited to a bank account has priority as against a security

right except a security right of a secured creditor that obtains control by becoming the account holder.

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

Priority of a security right in money

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

Priority of a security right in proceeds under an independent undertaking

105. The law should provide that a security right in proceeds under an independent undertaking that is made effective against third parties by control has priority as against a security right made effective against third parties pursuant to recommendation 49. If control has been achieved by acknowledgement and inconsistent acknowledgements have been given to more than one secured creditor by a person, priority among those security rights is determined according to the order in which the acknowledgements were given.

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

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

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

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

(b) The time when an agreement was made between the grantor and the secured creditor in possession of the negotiable document providing for the asset to be represented by a negotiable document so long as the asset became so represented within [specify a short period of time, such as 20 or 30 days] from the date of the agreement.

VIII. Rights and obligations of the parties

Purpose

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

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

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

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

A. General recommendations

Non-mandatory rules relating to the rights of the secured creditor

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

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

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

Mandatory rules relating to the obligations of the party in possession of an encumbered asset

109. The law should provide that:

(a) The secured creditor or the grantor in possession of an encumbered asset must take reasonable steps to preserve the value of the asset;

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

B. Asset-specific recommendations

Rights and obligations of the assignor and the assignee

110. The law should provide that:

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

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

Representations of the assignor

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

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

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

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

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

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

Right to notify the debtor of the receivable

112. The law should provide that:

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

(b) Notification of the assignment or a payment instruction sent in breach of any agreement referred to in subparagraph (a) of this recommendation is not ineffective for the purposes of recommendation 116 by reason of such breach. However, nothing in this recommendation affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

Right to payment

113. The law should provide that:

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

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

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

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

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

IX. Rights and obligations of third-party obligors

A. Rights and obligations of the debtor of the receivable

Purpose

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

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

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

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

Protection of the debtor of the receivable

[*Note to the Commission: The Commission may wish to note that recommendations 114-120 are based on articles 15-21 of the United Nations Assignment Convention.*]

114. The law should provide that:

(a) Except as otherwise provided in this law, an assignment does not, without the consent of the debtor of the receivable, affect the rights and obligations

of the debtor of the receivable, including the payment terms contained in the original contract;

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

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

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

Notification of the assignment

115. The law should provide that:

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

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

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

Discharge of the debtor of the receivable by payment

116. The law should provide that:

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

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

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

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

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

(f) If the debtor of the receivable receives notification of the assignment of a part of or an undivided interest in one or more receivables, it is discharged by paying in accordance with the notification or in accordance with this

recommendation as if the debtor of the receivable had not received the notification. If the debtor of the receivable pays in accordance with the notification, it is discharged only to the extent of the part or undivided interest paid;

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

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

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

117. The law should provide that:

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

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

(c) Notwithstanding subparagraphs (a) and (b) of this recommendation, defences and rights of set-off that the debtor of the receivable may raise pursuant to recommendation 25, subparagraph (b), or recommendation 26, subparagraph (e), against the assignor for breach of an agreement limiting in any way the assignor's right to make the assignment are not available to the debtor of the receivable against the assignee.

Agreement not to raise defences or rights of set-off

118. The law should provide that:

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

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

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

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

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

Modification of the original contract

119. The law should provide that:

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

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

(i) The assignee consents to it; or

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

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

Recovery of payments

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

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

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

C. Rights and obligations of the depositary bank

122. The law should provide that:

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

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

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

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

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

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

124. The law should provide that:

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

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

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

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

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

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

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

X. Enforcement

Purpose

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

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

(b) Methods that maximize the amount realized from the encumbered assets for the benefit of the grantor, the debtor or any other person that owes payment of the secured obligation, the secured creditor and other creditors with a right in the encumbered assets;

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

A. General recommendations

General standard of conduct in the context of enforcement

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

Limitations on party autonomy

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

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

131. The law should provide that, subject to recommendation 129, the secured creditor may waive unilaterally or vary by agreement any of its rights under the recommendations in this chapter.

132. The law should provide that a variation of rights by agreement may not adversely affect the rights of any person not a party to the agreement. A person challenging the agreement has the burden of showing that it was made prior to default or is inconsistent with recommendation 128 or 129.

Liability

133. The law should provide that, if a person fails to comply with its obligations under the recommendations in this chapter, it is liable to damages.

Post-default rights of the secured creditor

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

(a) Obtain possession of a tangible encumbered asset, as provided in recommendations 142 and 143;

(b) Sell or otherwise dispose of, lease or license an encumbered asset, as provided in recommendations 144-147;

(c) Propose to the grantor that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendations 148-150;

(d) Collect on or otherwise enforce a security right in an encumbered asset that is a receivable, negotiable instrument, right to payment of funds credited to a bank account or proceeds under an independent undertaking, as provided in recommendations 162-170;

(e) Enforce rights under a negotiable document, as provided in recommendation 171;

(f) Enforce its security right in an attachment to immovable property, as provided in recommendation 172; and

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

Post-default rights of the grantor

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

(a) Pay in full the secured obligation and obtain a release from the security right of all encumbered assets, as provided in recommendation 140;

(b) Apply to a court or other authority for relief if the secured creditor is not complying with its obligations under the provisions of this law, as provided in recommendation 141;

(c) Propose to the secured creditor, or reject the proposal of the secured creditor, that the secured creditor accept an encumbered asset in total or partial satisfaction of the secured obligation, as provided in recommendation 151; and

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

Judicial and extrajudicial methods of exercising post-default rights

136. The law should provide that after default the secured creditor may exercise its rights provided in recommendation 134 by applying to a court or other authority. Subject to the general standard of conduct provided in recommendation 128 and the requirements provided in recommendations 142-147 with respect to extrajudicial obtaining of possession and disposition of an encumbered asset, the secured creditor may elect to exercise its rights provided in recommendation 134 without having to apply to a court or other authority.

Expeditious judicial proceedings

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

Cumulative post-default rights

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

Post-default rights with respect to the secured obligation

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

Release of the encumbered assets after full payment

140. The law should provide that, after default and until the disposition, acceptance or collection of an encumbered asset by the secured creditor, the debtor, the grantor or any other interested person (e.g. a secured creditor whose security right has lower priority than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered asset) is entitled to pay the secured obligation in full, including interest and the costs of enforcement up to the time of full payment. If all commitments to extend credit have terminated, full payment extinguishes the security right in all encumbered assets, subject to any rights of subrogation in favour of the person making the payment.

Judicial or other relief for non-compliance

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

Secured creditor's right to possession of an encumbered asset

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

Extrajudicial obtaining of possession of an encumbered asset

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

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

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

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

Extrajudicial disposition of an encumbered asset

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

Advance notice of extrajudicial disposition of an encumbered asset

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

146. The law should provide rules ensuring that the notice referred to in recommendation 145 can be given in an efficient, timely and reliable way so as to protect the grantor or other interested parties, while, at the same time, avoiding having a negative effect on the secured creditor's remedies and the potential net realization value of the encumbered assets.

147. With respect to the notice referred to in recommendation 145, the law should:

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

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

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

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

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

(b) State the manner in which the notice must be given, its timing and its minimum contents, including whether the notice must contain an accounting of the amount then owed and a reference to the right of the debtor or the grantor to obtain the release of the encumbered assets from the security right as provided in recommendation 140; and

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

Acceptance of encumbered assets in satisfaction of the secured obligation

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

149. With respect to the proposal referred to in recommendation 148, the law should:

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

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

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

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

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

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

150. The law should provide that the secured creditor may proceed with the proposal referred to in recommendation 148, unless any addressee of a proposal under recommendation 149 objects in writing within a short time, such as [to be specified] days, after the proposal is sent. In the case of a proposal for the acceptance of the encumbered asset in partial satisfaction, affirmative consent by any addressee of the proposal is necessary.

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

Distribution of proceeds of disposition of an encumbered asset

152. The law should provide that, in the case of extrajudicial disposition of an encumbered asset or collection of a receivable, negotiable instrument or other obligation, the enforcing secured creditor must apply the net proceeds of its enforcement (after deducting costs of enforcement) to the secured obligation. Except as provided in recommendation 153, the enforcing secured creditor must pay any surplus remaining to any subordinate competing claimant, that, prior to any distribution of the surplus, notified the enforcing secured creditor of the subordinate competing claimant's claim, to the extent of that claim. Any balance remaining must be remitted to the grantor.

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

154. The law should provide that distribution of the proceeds realized by a judicial disposition or other officially administered enforcement process is to be made

pursuant to the general rules of the State governing execution proceedings, but in accordance with the recommendations in chapter VII on priority.

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

Right of prior-ranking secured creditor to take over enforcement

156. The law should provide that, where a secured creditor or a judgement creditor has commenced enforcement, a secured creditor whose security right has priority as against that of the enforcing secured creditor or the enforcing judgement creditor is entitled to take control of the enforcement process at any time before final disposition, acceptance or collection of an encumbered asset. The right to take control includes the right to enforce by any method available under the recommendations in this chapter.

Rights acquired through judicial disposition

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

Rights acquired through extrajudicial disposition

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

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

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

Intersection of movable and immovable property enforcement regimes

161. The law should provide that:

(a) The secured creditor may elect to enforce a security right in an attachment to immovable property in accordance with the recommendations in this

chapter or the law governing enforcement of encumbrances in immovable property; and

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

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

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

B. Asset-specific recommendations

Application of the chapter on enforcement to outright transfers of receivables

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

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

(b) Recommendations 163 and 164.

Enforcement of a security right in a receivable

163. The law should provide that, in the case of a receivable transferred by an outright transfer, the assignee has the right to collect or otherwise enforce the receivable. In the case of a receivable transferred by way of security, the assignee is entitled, subject to recommendations 114-120, to collect or otherwise enforce the receivable after default, or before default with the agreement of the assignor.

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

Enforcement of a security right in a negotiable instrument

165. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 121, to collect or otherwise enforce a negotiable instrument that is an encumbered asset against a person obligated on that instrument.

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

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

167. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor with a security right in a right to payment of funds

credited to a bank account is entitled, subject to recommendations 122 and 123, to collect or otherwise enforce its right to payment of the funds.

168. The law should provide that a secured creditor that has control is entitled, subject to recommendations 122 and 123, to enforce its security right without having to apply to a court or other authority.

169. The law should provide that a secured creditor that does not have control is entitled, subject to recommendations 122 and 123, to collect or otherwise enforce the security right against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

Enforcement of a security right in proceeds under an independent undertaking

170. The law should provide that after default, or before default with the agreement of the grantor, a secured creditor with a security right in proceeds under an independent undertaking is entitled, subject to recommendations 124-126, to collect or otherwise enforce its right in the proceeds under the independent undertaking.

Enforcement of a security right in a negotiable document or goods covered by a negotiable document

171. The law should provide that after default, or before default with the agreement of the grantor, the secured creditor is entitled, subject to recommendation 127, to enforce a security right in a negotiable document against the issuer or any other person obligated on the negotiable document.

Enforcement of a security right in an attachment to immovable property

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

XI. Acquisition financing

A. Unitary approach

Purpose

The purpose of the provisions of the law on acquisition security rights is:

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

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

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

Equivalence of an acquisition security right to a security right

173. The law should provide that an acquisition security right is a security right. Thus, all the recommendations governing security rights, including those on creation, third-party effectiveness (except as provided in recommendation 174), registration, enforcement and conflict of laws, apply to acquisition security rights. The recommendations on priority also apply (except as provided in recommendations 175, 176 and 178-183).

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

174. The law should provide that an acquisition security right in consumer goods is effective against third parties upon its creation and, except as provided in recommendation 178, has priority as against a competing non-acquisition security right created by the grantor.

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

175. The law should provide that, except as provided in recommendation 178, an acquisition security right in a tangible asset other than inventory or consumer goods has priority as against a competing non-acquisition security right created by the grantor (even if a notice of that security right was registered in the general security rights registry before registration of a notice of the acquisition security right), provided that:

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

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

Priority of an acquisition security right in inventory

176. The law should provide that, except as provided in recommendation 178, an acquisition security right in inventory has priority as against a competing non-acquisition security right created by the grantor (even if that security right became effective against third parties before the acquisition security right became effective against third parties), provided that:

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

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

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

(ii) A secured creditor with an earlier-registered non-acquisition security right created by the grantor in inventory of the same kind is notified by the acquisition secured creditor of its intention to acquire an acquisition security right. The notice must describe the inventory sufficiently to enable the non-

acquisition secured creditor to identify the inventory that is the object of the acquisition security right.

One notice sufficient

177. The law should provide that a notice sent pursuant to recommendation 176, subparagraph (b)(ii), may cover acquisition security rights under multiple transactions between the same parties without the need to identify each transaction. The notice is effective only for security rights in tangible assets of which the grantor obtains possession within a period of [specify time, such as five years] after the notice is given.

Priority of security rights subject to specialized registries

178. The law should provide that the priority under recommendations 174-176 does not override the priority under recommendation 83.

Priority between competing acquisition security rights

179. The law should provide that an acquisition security right of a supplier that is made effective against third parties within the period specified in recommendation 175, subparagraph (b), has priority as against a competing acquisition security right.

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

180. The law should provide that an acquisition security right that is made effective against third parties within the period provided in recommendation 175, subparagraph (b), has priority as against the rights of an unsecured creditor that would otherwise have priority under recommendation 90.

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

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

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

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

Priority of an acquisition security right in proceeds of inventory

183. The law should provide that an acquisition security right in proceeds of inventory other than receivables, negotiable instruments, funds credited in a bank account and the obligation to pay under an independent undertaking has the same priority as the acquisition security right in that inventory. However, the acquisition

secured creditor must notify earlier secured creditors that have registered a notice of a security right in assets of the same kind as the proceeds before the time the proceeds arise.

B. Non-unitary approach to acquisition financing

Purpose (non-unitary approach)

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

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

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

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

Methods of acquisition financing

173. The law should provide for a regime of acquisition security rights identical to that adopted in the unitary system. All creditors, both suppliers and lenders, may acquire an acquisition security right in conformity with that regime. In addition, the law should provide for acquisition financing based on retention-of-title rights and financial lease rights. The law should further provide that a lender may acquire the benefit of a retention-of-title right and a financial lease right through an assignment or subrogation.

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

173bis The law should provide that the rules governing acquisition financing produce functionally equivalent economic results regardless of whether the creditor's right is a retention-of-tile right, a financial lease right or an acquisition security right.

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

173tres The law should provide that a retention-of-title right or a financial lease right in a tangible asset is not effective unless the sale or lease agreement is concluded in or evidenced by a writing that in conjunction with the course of conduct between the parties indicates the seller's or the lessor's intent to retain ownership. The writing must exist not later than the time when the buyer or lessee obtains possession of the asset.

Right of buyer or lessee to create a security right

173quater The law should provide that a buyer or lessee may create a security right in a tangible asset that is the object of a retention-of-title right or a financial lease right. The security right encumbers the asset only to the extent of the asset's value in excess of the amount owing to the seller or financial lessor.

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

174. The law should provide that a retention-of-title and a financial lease right in consumer goods is effective against third parties upon conclusion of the sale or lease provided that the right is evidenced in accordance with recommendation 173tres.

Third-party effectiveness of a retention-of-title right in a tangible asset other than inventory or consumer goods

Alternative A

175. The law should provide that a retention-of-title right or a financial lease right in tangible asset other than inventory or consumer goods is effective against third parties only if:

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

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

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

176. The law should provide that a retention-of-title right or a financial lease right in inventory is effective against third parties only if:

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

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

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

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

One notice sufficient

177. The law should provide that a notice sent pursuant to recommendation 176, subparagraph (b)(ii), may cover retention-of-title rights and financial lease rights under multiple transactions between the same parties without the need to identify each transaction. The notice is effective only for rights in tangible assets of which the buyer or lessee obtains possession within a period of [specify time, such as five years] years after the notice is given.

Alternative B

Third-party effectiveness of a retention-of-title right or financial lease right in a tangible asset other than consumer goods

176. The law should provide that a retention-of-title right or financial lease right in a tangible asset other than consumer goods is effective against third parties only if:

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

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

One registration sufficient

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

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

178. The law should provide that, if a retention-of-title right or a financial lease right is not effective against third parties, ownership of the asset as against third parties passes to the buyer or lessee, and the seller or lessor has a security right in the asset subject to the recommendations applicable to security rights.

179. …

180. …

Third-party effectiveness of a retention-of-title or financial lease right in an attachment to immovable property as against earlier registered competing rights in the immovable property

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

181bis The law should provide that the rule in recommendation 178 applies in the case of a retention-of-title right or financial lease right that is not effective against third parties under recommendation 181.

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

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

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

183. The law should provide that a security right in proceeds referred to in recommendation 182 is effective against third parties only if the proceeds are described in a generic way in the registered notice by which the retention-of-title right or financial lease right was made effective against third parties or the proceeds consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

183bis If recommendation 183 does not apply, the security right in the proceeds is effective against third parties for [to be specified] days after the proceeds arise and continuously thereafter, if it was made effective against third parties by one of the methods referred to in recommendation 33 or 35 before the expiry of that time period.

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

183tres The law should provide that, if a retention-of-title right or financial lease right is effective against third parties, the security right in proceeds referred to in recommendation 182 has priority as against an earlier registered security right in the same asset.

Priority of a security right in proceeds of inventory

183quater The law should provide that, if a retention-of-title right or financial lease right is effective against third parties, the security right in proceeds referred to in recommendation 182 has priority as against an earlier registered security right in inventory of the same kind other than receivables, negotiable instruments, funds credited in a bank account and the obligation to pay under an independent undertaking. However, the seller or lessor must notify earlier secured creditors that have registered a notice of a security right in assets of the same kind as the proceeds before the time the proceeds arise.

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

183quinquiens The law should provide rules for the post-default enforcement of a retention-of-title right or a financial lease right in a tangible asset that deal with:

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

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

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

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

183sixiens The law should provide that the regime that applies to the post-default enforcement of a security right applies to the post-default enforcement of a retention-of-title right or a financial lease right except to the extent necessary to preserve the coherence of the regime applicable to sale and lease.

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

183septiens The law should provide conflict-of-laws rules for retention-of-title rights and financial lease rights that are the same as the conflict-of-laws rules for security rights.

XII. Conflict of laws *

Purpose

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

A. General recommendations

Law applicable to a security right in tangible assets

184. The law should provide that, except as provided in recommendations 185-188 and 192, the creation, third-party effectiveness and priority of a security right in a tangible asset are governed by the law of the State in which the asset is located.

185. The law should provide that the law of the State in which the grantor is located governs the issues mentioned in recommendation 184 with respect to a security right in a tangible asset of a type ordinarily used in more than one State.

186. The law should provide that, if a tangible asset that is subject to registration in a specialized registry or notation on a title certificate providing for registration or notation of a security right, the issues mentioned in recommendation 184 are governed by the law of the State under whose authority the registry is maintained or the title certificate is issued.

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

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

188. The law should provide that a security right in a tangible asset (other than a negotiable instrument or a negotiable document) in transit or to be exported from the State in which it is located at the time of the creation of the security right may be created and made effective against third parties under the law of the State of the

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

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

initial location of the asset as provided in recommendation 184 or under the law of the State of its ultimate destination, provided that the asset reaches that State within a short time period of [to be specified] days after the time of creation of the security right.

Law applicable to a security right in intangible assets

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

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

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

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

191. Except as otherwise provided in recommendation 192, the law should provide that the creation, third-party effectiveness, priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as, rights and duties of the depositary bank with respect to the security right, are governed by

Alternative A

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

Alternative B

the law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, the law of the State determined pursuant to the preceding sentence applies only if the depositary bank has, at the time of the conclusion of the account agreement, an office in that State that is engaged in the regular activity of maintaining bank accounts. If the applicable law is not determined pursuant to the preceding two sentences, the applicable law is to be determined pursuant to default rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary. [A State that adopts alternative B, has to also adopt recommendations 206 and 207.]

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

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

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

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

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

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

(c) Except as provided in recommendation 195, the third-party effectiveness and priority of a security right in proceeds under the independent undertaking.

194. If the applicable law is not specified in the independent undertaking of the guarantor/issuer or confirmer, the law governing the matters referred to in recommendation 193 is the law of the State of the location of the branch or office of the guarantor/issuer or confirmer indicated in the independent undertaking. However, in the case of a nominated person, the applicable law is the law of the State of the location of the nominated person's branch or office that has or may pay or otherwise give value under the independent undertaking.

195. The law should provide that the law of the State whose law governs the creation and third-party effectiveness of a security right in a receivable, negotiable instrument or other claim, the payment or other performance of which is secured by an independent undertaking, also governs whether a security right in the proceeds under the independent undertaking is created and made effective against third parties automatically as contemplated in recommendations 26 and 49.

Law applicable to a security right in proceeds

196. The law should provide that:

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

(b) The third-party effectiveness and priority of a security right in proceeds are governed by the law of the State whose law governs the third-party effectiveness and priority of a security right in an asset of the same kind as the proceeds.

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

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

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

198. The law should provide that the law of the State whose law governs a receivable, negotiable instrument or negotiable document also governs: :

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

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

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

Law applicable to enforcement of a security right

199. The law should provide that, subject to recommendation 216, issues relating to the enforcement of a security right:

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

(b) In an intangible asset are governed by the law of the State whose law governs the priority of the security right.

Meaning of "location" of the grantor

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

Relevant time when determining location

201. The law should provide that:

(a) Except as provided in subparagraph (b) of this recommendation, references to the location of the assets or of the grantor in the conflict-of-laws

provisions refer, for creation issues, to the location at the time of the putative creation of the security right and, for third-party effectiveness and priority issues, to the location at the time the issue arises;

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

Exclusion of renvoi

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

Public policy and internationally mandatory rules

203. The law should provide that:

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

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

(c) The rules in subparagraphs (a) and (b) of this recommendation do not permit the application of the provisions of the law of the forum on third-party effectiveness and priority of a security right.

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

204. The law should provide that in situations in which the State whose law governs an issue is a multi-unit State subject to recommendation 205, references to the law of a multi-unit State are to the law of the relevant territorial unit (as determined on the basis of the location of the grantor or of an encumbered asset or otherwise under the recommendations in this chapter) and, to the extent applicable in that unit, to the law of the multi-unit State itself.

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

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

(a) The references to "State" in the first sentence of recommendation 191 (alternative B) are to the territorial unit;

(b) The references to "that State" in the second sentence of recommendation 191 (alternative B) are to the multi-unit State itself.

207. The law should provide that the law of a territorial unit applies if:

(a) Under recommendations 191 (alternative B) and 205, the designated law is that of a territorial unit of a multi-unit State;

(b) Under the law of that State the law of a territorial unit applies only if the depositary bank has an office within that territorial unit which satisfies the condition specified in the second sentence of recommendation 191 (alternative B); and

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

[Only a State that adopts recommendation 191 (alternative B) needs to adopt recommendations 206 and 207.]

XIII. Transition

Purpose

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

Effective date

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

Inapplicability of the law to matters in litigation or subject to enforcement

209. The law should provide that it does not apply to matters that, at the effective date, are subject to litigation (or a comparable dispute resolution system). If enforcement of a security right has commenced before the effective date, the enforcement may continue under the law in effect immediately before the effective date.

Creation of a security right

210. The law should provide that the existence of a security right created under the law in effect immediately before the effective date is determined by that law.

Third-party effectiveness of a security right

211. The law should provide that a security right made effective against third parties under the law in effect immediately before the effective date remains effective against third parties until the earlier of the time it would cease to be effective against third parties under the law in effect immediately before the effective date and the expiration of a period of [specify length of the transition

period] after the effective date ("the transition period"). If, during that time of third-party effectiveness or such longer period provided in recommendation 212, the secured creditor takes any steps necessary to ensure that the security right is made effective against third parties under this law, its effectiveness against third parties is continuous.

212. The law should provide that the time when the security right was made effective against third parties or became the subject of a registered notice, as applicable, is the time when such security right was made effective against third parties or became the subject of a registered notice under the law in effect immediately before the effective date. This rule applies for purposes of determining priority of a security right that was effective against third parties under the law in effect immediately before the effective date and is continuously effective against third parties under this law.

Priority of a security right

213. Subject to recommendations 214 and 215, the law should provide that the priority of a security right as against the right of a competing claimant is governed by this law.

214. The law should provide that the priority of a security right as against the right of a competing claimant is determined by the law in effect immediately before the effective date if:

(a) Both the security right and the right of the competing claimant are created before the effective date; and

(b) The status of neither right has changed since the effective date.

215. The status of a security right has changed if:

(a) It was effective against third parties on the effective date in accordance with recommendation 211 and later ceased to be effective against third parties; or

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

XIV. Insolvency

A. *UNCITRAL Legislative Guide on Insolvency Law*:[3] definitions and recommendations

Definitions

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

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

12. (r) “Financial contract”: any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above;

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

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

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

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

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

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

(iii) The set-off of amounts calculated as set forth in subparagraph (ii) of this definition under two or more netting agreements.[4]

12. (dd) “Party in interest”: any party whose rights, obligations or interests are affected by insolvency proceedings or particular matters in the insolvency proceedings, including the debtor, the insolvency representative, a creditor, an equity holder, a creditor committee, a government authority or any other person so affected. It is not intended that persons with remote or diffuse interests affected by the insolvency proceedings would be considered to be a party in interest;

12. (ff) “Preference”: a transaction which results in a creditor obtaining an advantage or irregular payment;

12. (gg) “Priority”: the right of a claim to rank ahead of another claim where that right arises by operation of law;

12. (hh) “Priority claim”: a claim that will be paid before payment of general unsecured creditors;

12. (ii) “Protection of value”: measures directed at maintaining the economic value of encumbered assets and third-party-owned assets during the insolvency proceedings (in some jurisdictions referred to as “adequate protection”). Protection may be provided by way of cash payments, provision of security interests over alternative or additional assets or by other means as determined by a court to provide the necessary protection;

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[4] United Nations Convention on the Assignment of Receivables in International Trade (United Nations publication, Sales No. E.04.V.14), article 5, subparagraph (1).

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

Recommendations

Key objectives of an efficient and effective insolvency law

(1) In order to establish and develop an effective insolvency law, the following key objectives should be considered:

(a) Provide certainty in the market to promote economic stability and growth;

(b) Maximize value of assets;

(c) Strike a balance between liquidation and reorganization;

(d) Ensure equitable treatment of similarly situated creditors;

(e) Provide for timely, efficient and impartial resolution of insolvency;

(f) Preserve the insolvency estate to allow equitable distribution to creditors;

(g) Ensure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information; and

(h) Recognize existing creditors’ rights and establish clear rules for ranking of priority claims.

(4) The insolvency law should specify that where a security interest is effective and enforceable under law other than the insolvency law, it will be recognized in insolvency proceedings as effective and enforceable.

(7) In order to design an effective and efficient insolvency law, the following common features should be considered:

(a)-(d) …

(e) Protection of the insolvency estate against the actions of creditors, the debtor itself and the insolvency representative, and where the protective measures apply to secured creditors, the manner in which the economic value of the security interest will be protected during the insolvency proceedings;

(f)-(r) …

Law applicable to validity and effectiveness of rights and claims

(30) The law applicable to the validity and effectiveness of rights and claims existing at the time of the commencement of insolvency proceedings should be determined by the private international law rules of the State in which insolvency proceedings are commenced.

Law applicable in insolvency proceedings: lex fori concursus

(31) The insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) should apply to all aspects of the commencement, conduct, administration and conclusion of those insolvency proceedings and their effects. These may include, for example:

(a)-(i) …

(j) Treatment of secured creditors;

(k)-(n) …

(o) Ranking of claims;

(p)-(s) …

Assets constituting the insolvency estate

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

(a) Assets of the debtor,[5] including the debtor's interest in encumbered assets and in third-party-owned assets;

(b) Assets acquired after commencement of the insolvency proceedings; and

(c) …

Provisional measures[6]

(39) The insolvency law should specify that the court may grant relief of a provisional nature, at the request of the debtor, creditors or third parties, where relief is needed to protect and preserve the value of the assets of the debtor[7] or the interests of creditors, between the time an application to commence insolvency proceedings is made and commencement of the proceedings,[8] including:

(a) Staying execution against the assets of the debtor, including actions to make security interests effective against third parties and enforcement of security interests;

(b)-(d) …

Measures applicable on commencement

(46) The insolvency law should specify that, on commencement of insolvency proceedings:[9]

(a) Commencement or continuation of individual actions or proceedings[10] concerning the assets of the debtor, and the rights, obligations or liabilities of the debtor are stayed;

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[5] Ownership of assets would be determined by reference to the relevant applicable law, where the term "assets" is defined broadly to include property, rights and interest of the debtor, including the debtor's rights and interests in third-party-owned assets.

[6] These articles follow the corresponding articles of the UNCITRAL Model Law on Cross-Border Insolvency, see article 19 (see annex III of the *UNCITRAL Insolvency Guide*).

[7] The reference to assets in paragraphs (a)-(c) is intended to be limited to assets that would be part of the insolvency estate once proceedings commence.

[8] The insolvency law should indicate the time of effect of an order for provisional measures, for example, at the time of the making of the order, retrospectively from the commencement of the day on which the order is made or some other specified time (see para. 44 of the *UNCITRAL Insolvency Guide*).

[9] These measures would generally be effective as at the time of the making of the order for commencement.

(b) Actions to make security interests effective against third parties and to enforce security interests are stayed;[11]

(c) Execution or other enforcement against the assets of the estate is stayed;

(d) The right of a counterparty to terminate any contract with the debtor is suspended;[12] and

(e) The right to transfer, encumber or otherwise dispose of any assets of the estate is suspended.[13]

Duration of measures automatically applicable on commencement

(49) The insolvency law should specify that the measures applicable on commencement of insolvency proceedings remain effective throughout those proceedings until:

(a) The court grants relief from the measures;[14]

(b) In reorganization proceedings, a reorganization plan becomes effective;[15] or

(c) In the case of secured creditors in liquidation proceedings, a fixed time period specified in the law expires,[16] unless it is extended by the court for a further period on a showing that:

(i) An extension is necessary to maximize the value of assets for the benefit of creditors; and

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[10] See UNCITRAL Model Law on Cross-Border Insolvency, article 20 (see annex III of the *UNCITRAL Insolvency Guide*). It is intended that the individual actions referred to in subparagraph (a) of recommendation 46 would also cover actions before an arbitral tribunal. It may not always be possible, however, to implement the automatic stay of arbitral proceedings, such as where the arbitration does not take place in the State but in a foreign location.

[11] If law other than the insolvency law permits those security interests to be made effective within certain specified time periods, it is desirable that the insolvency law recognize those periods and permit the interest to be made effective where the commencement of insolvency proceedings occurs before expiry of the specified time period. Where law other than the insolvency law does not include such time periods, the stay applicable on commencement would operate to prevent the security interest being made effective. (For further discussion see para. 32 of the *UNCITRAL Insolvency Guide*, and the UNCITRAL Legislative Guide on Secured Transactions.)

[12] See *UNCITRAL Insolvency Guide*, paragraphs 114-119. This recommendation is not intended to preclude the termination of a contract if the contract provides for a termination date that happens to fall after the commencement of insolvency proceedings.

[13] The limitation on the right to transfer, encumber or otherwise dispose of assets of the estate may be subject to an exception in those cases where the continued operation of the business by the debtor is authorized and the debtor can transfer, encumber or otherwise dispose of assets in the ordinary course of business.

[14] Relief should be granted on the grounds included in recommendation 51 of the *UNCITRAL Insolvency Guide*.

[15] A plan may become effective upon approval by creditors or following confirmation by the court, depending upon the requirements of the insolvency law (see *UNCITRAL Insolvency Guide*, chap. IV, paras. 54 and following).

[16] It is intended that the stay should apply to secured creditors only for a short period of time, such as between 30 and 60 days, and that the insolvency law should clearly state the period of application.

(ii) The secured creditor will be protected against diminution of the value of the encumbered asset in which it has a security interest.

Protection from diminution of the value of encumbered assets

(50) The insolvency law should specify that, upon application to the court, a secured creditor should be entitled to protection of the value of the asset in which it has a security interest. The court may grant appropriate measures of protection that may include:

(a) Cash payments by the estate;

(b) Provision of additional security interests; or

(c) Such other means as the court determines.

Relief from measures applicable on commencement

(51) The insolvency law should specify that a secured creditor may request the court to grant relief from the measures applicable on commencement of insolvency proceedings on grounds that may include that:

(a) The encumbered asset is not necessary to a prospective reorganization or sale of the debtor's business;

(b) The value of the encumbered asset is diminishing as a result of the commencement of insolvency proceedings and the secured creditor is not protected against that diminution of value; and

(c) In reorganization, a plan is not approved within any applicable time limits.

Power to use and dispose of assets of the estate

(52) The insolvency law should permit:

(a) The use and disposal of assets of the estate (including encumbered assets) in the ordinary course of business, except cash proceeds; and

(b) The use and disposal of assets of the estate (including encumbered assets) outside the ordinary course of business, subject to the requirements of recommendations 55 and 58.

Further encumbrance of encumbered assets

(53) The insolvency law should specify that encumbered assets may be further encumbered, subject to the requirements of recommendations 65-67.

Use of third-party-owned assets

(54) The insolvency law should specify that the insolvency representative may use an asset owned by a third party and in the possession of the debtor provided specified conditions are satisfied, including:

(a) The interests of the third party will be protected against diminution in the value of the asset; and

(b) The costs under the contract of continued performance of the contract and use of the asset will be paid as an administrative expense.

Ability to sell assets of the estate free and clear of encumbrances and other interests

(58) The insolvency law should permit the insolvency representative to sell assets that are encumbered or subject to other interest free and clear of that encumbrance and other interest, outside the ordinary course of business, provided that:

(a) The insolvency representative gives notice of the proposed sale to the holders of encumbrances or other interests;

(b) The holder is given the opportunity to be heard by the court where they object to the proposed sale;

(c) Relief from the stay has not been granted; and

(d) The priority of interests in the proceeds of sale of the asset is preserved.

Use of cash proceeds

(59) The insolvency law should permit the insolvency representative to use and dispose of cash proceeds if:

(a) The secured creditor with a security interest in those cash proceeds consents to such use or disposal; or

(b) The secured creditor was given notice of the proposed use or disposal and an opportunity to be heard by the court; and

(c) The interests of the secured creditor will be protected against diminution in the value of the cash proceeds.

Burdensome assets

(62) The insolvency law should permit the insolvency representative to determine the treatment of any asset that is burdensome to the estate. In particular, the insolvency law may permit the insolvency representative to relinquish a burdensome asset following the provision of notice to creditors and the opportunity for creditors to object to the proposed action, except that where a secured claim exceeds the value of the encumbered asset, and the asset is not required for a reorganization or sale of the business as a going concern, the insolvency law may permit the insolvency representative to relinquish the asset to the secured creditor without notice to other creditors.

Security for post-commencement finance

(65) The insolvency law should enable a security interest to be granted for repayment of post-commencement finance, including a security interest on an unencumbered asset, including an after-acquired asset, or a junior or lower priority security interest on an already encumbered asset of the estate.

(66) The law[17] should specify that a security interest over the assets of the estate to secure post-commencement finance does not have priority ahead of any existing

[17] This rule may be in a law other than the insolvency law, in which case the insolvency law

security interest over the same assets unless the insolvency representative obtains the agreement of the existing secured creditor(s) or follows the procedure in recommendation 67.

(67) The insolvency law should specify that, where the existing secured creditor does not agree, the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

(a) The existing secured creditor was given the opportunity to be heard by the court;

(b) The debtor can prove that it cannot obtain the finance in any other way; and

(c) The interests of the existing secured creditor will be protected.[18]

Effect of conversion on post-commencement finance

(68) The insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation.[19]

Automatic termination and acceleration clauses

(70) The insolvency law should specify that any contract clause that automatically terminates or accelerates a contract upon the occurrence of any of the following events is unenforceable as against the insolvency representative and the debtor:

(a) An application for commencement, or commencement, of insolvency proceedings;

(b) The appointment of an insolvency representative.[20]

(71) The insolvency law should specify the contracts that are exempt from the operation of recommendation 70, such as financial contracts, or subject to special rules, such as labour contracts.

Continuation or rejection

(72) The insolvency law should specify that the insolvency representative may decide to continue the performance of a contract of which it is aware where

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should note the existence of the provision.

[18] See *UNCITRAL Insolvency Guide*, paragraphs 63-69.

[19] The same order of priority may not necessarily be recognized. For example, post-commencement finance may rank in priority after administrative claims relating to the costs of the liquidation.

[20] This recommendation would apply only to those contracts where such clauses could be overridden (see commentary of the *UNCITRAL Insolvency Guide*, paras. 143-145, on exceptions) and is not intended to be exclusive, but to establish a minimum: the court should be able to examine other contractual clauses that would have the effect of terminating a contract on the occurrence of similar events.

continuation would be beneficial to the insolvency estate.[21] The insolvency law should specify that:

(a) The right to continue applies to the contract as a whole; and

(b) The effect of continuation is that all terms of the contract are enforceable.

Performance prior to continuation or rejection

(80) The insolvency law should specify that the insolvency representative may accept or require performance from the counterparty to a contract prior to continuation or rejection of the contract. Claims of the counterparty arising from performance accepted or required by the insolvency representative prior to continuation or rejection of the contract should be payable as an administrative expense:

(a) If the counterparty has performed the contract the amount of the administrative expense should be the contractual price of the performance; or

(b) If the insolvency representative uses assets owned by a third party that are in the possession of the debtor subject to contract, that party should be protected against diminution of the value of those assets and have an administrative claim in accordance with subparagraph (a).

Avoidance of security interests

(88) The insolvency law should specify that notwithstanding that a security interest is effective and enforceable under law other than the insolvency law, it may be subject to the avoidance provisions of insolvency law on the same grounds as other transactions.

Financial contracts

(103) Once the financial contracts of the debtor have been terminated, the insolvency law should permit counterparties to enforce and apply their security interest to obligations arising out of financial contracts. Financial contracts should be exempt from any stay under the insolvency law that applies to the enforcement of a security interest.

Participation by creditors

(126) The insolvency law should specify that creditors, both secured and unsecured, are entitled to participate in insolvency proceedings and identify what that participation may involve in terms of the functions that may be performed.

[21] Provided the automatic stay on commencement of proceedings applies to prevent termination (pursuant to an automatic termination clause) of contracts with the debtor, all contracts should remain in place to enable the insolvency representative to consider the possibility of continuation, unless the contract has a termination date that happens to fall after the commencement of insolvency proceedings.

Right to be heard and to request review

(137) The insolvency law should specify that a party in interest has a right to be heard on any issue in the insolvency proceedings that affects its rights, obligations or interests. For example, a party in interest should be entitled:

(a) To object to any act that requires court approval;

(b) To request review by the court of any act for which court approval was not required or not requested; and

(c) To request any relief available to it in insolvency proceedings.

Right of appeal[22]

(138) The insolvency law should specify that a party in interest may appeal from any order of the court in the insolvency proceedings that affects its rights, obligations or interests.

Reorganization plan

Approval by classes

(150) Where voting on approval of the plan is conducted by reference to classes, the insolvency law should specify how the vote achieved in each class would be treated for the purposes of approval of the plan. Different approaches may be taken, including requiring approval by all classes or approval by a specified majority of the classes, but at least one class of creditors whose rights are modified or affected by the plan must approve the plan.

(151) Where the insolvency law does not require a plan to be approved by all classes, the insolvency law should address the treatment of those classes which do not vote to approve a plan that is otherwise approved by the requisite classes. That treatment should be consistent with the grounds set forth in recommendation 152.

Confirmation of an approved plan

(152) Where the insolvency law requires court confirmation of an approved plan, the insolvency law should require the court to confirm the plan if the following conditions are satisfied:

(a) The requisite approvals have been obtained and the approval process was properly conducted;

(b) Creditors will receive at least as much under the plan as they would have received in liquidation, unless they have specifically agreed to receive lesser treatment;

(c) The plan does not contain provisions contrary to law;

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[22] In accordance with the key objectives, the insolvency law should provide that appeals in insolvency proceedings should not have suspensive effect unless otherwise determined by the court, in order to ensure that insolvency can be addressed and resolved in an orderly, quick and efficient manner without undue disruption. Time limits for appeal should be in accordance with generally applicable law, but in insolvency need to be shorter than otherwise to avoid interrupting insolvency proceedings.

(d) Administrative claims and expenses will be paid in full, except to the extent that the holder of the claim or expense agrees to different treatment; and

(e) Except to the extent that affected classes of creditors have agreed otherwise, if a class of creditors has voted against the plan, that class shall receive under the plan full recognition of its ranking under the insolvency law and the distribution to that class under the plan should conform to that ranking.

Challenges to approval (where there is no requirement for confirmation)

(153) Where a plan becomes binding on approval by creditors, without requiring confirmation by the court, the insolvency law should permit parties in interest, including the debtor, to challenge the approval of the plan. The insolvency law should specify criteria against which a challenge can be assessed, which should include:

(a) Whether the grounds set forth in recommendation 152 are satisfied; and

(b) Fraud, in which case the requirements of recommendation 154 should apply.

Secured claims

(172) The insolvency law should specify whether secured creditors are required to submit claims.

Valuation of secured claims

(179) The insolvency law should provide that the insolvency representative may determine the portion of a secured creditor's claim that is secured and the portion that is unsecured by valuing the encumbered asset.

Priority of claims

Secured claims

(188) The insolvency law should specify that secured claims should be satisfied from the encumbered asset in liquidation or pursuant to a reorganization plan, subject to claims that are superior in priority to the secured claim, if any. Claims superior in priority to secured claims should be minimized and clearly set forth in the insolvency law. To the extent that the value of the encumbered asset is insufficient to satisfy the secured creditor's claim, the secured creditor may participate as an ordinary unsecured creditor.

B. Additional insolvency recommendations of the guide on secured transactions

Law applicable to security rights in insolvency proceedings

216. The insolvency law should provide, as set out in recommendation 30 of the *UNCITRAL Legislative Guide on Insolvency Law*, that, notwithstanding the commencement of insolvency proceedings, the creation, effectiveness against third parties, priority and enforcement of a security right are governed by the law that

would be applicable in the absence of the insolvency proceedings. However, this recommendation does not affect the application of the insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) on matters such as avoidance, treatment of secured creditors, ranking of claims or distribution of proceeds, as provided in recommendation 31 of the *UNCITRAL Insolvency Guide*.

[*Note to the Commission: The Commission may wish to note that recommendation 217 is included in this chapter and not in the chapter on acquisition financing rights to ensure that all insolvency-related issues are addressed in the chapter on insolvency. There are three versions of recommendation 217 , one for the unitary approach and two for the non-unitary approach (one with and the other without functional equivalence.)*]

Assets subject to an acquisition security right (unitary approach)

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

Assets subject to an acquisition financing right (non unitary approach)

Alternative A

217. The insolvency law should provide that, in the case of insolvency proceedings with respect to the debtor, assets subject to a retention-of-title right or a financial lease right are treated in the same way as assets subject to security rights generally.

Alternative B

217. The insolvency law should provide that, in the case of insolvency proceedings with respect to the debtor, assets subject to a retention-of-title right or a financial lease right are treated as third-party-owned assets as provided in the *UNCITRAL Insolvency Guide*.

Receivables subject to an outright transfer before commencement

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

Assets acquired after commencement

219. Except as provided in recommendation 220, the insolvency law should provide that an asset of the estate acquired after the commencement of insolvency proceedings is not subject to a security right created by the debtor before the commencement of the insolvency proceeding.

220. The insolvency law should provide that an asset of the estate acquired after the commencement of insolvency proceedings with respect to the debtor is subject to a security right created by the debtor before the commencement of the insolvency

proceedings to the extent the asset is proceeds (whether cash or non-cash) of an encumbered asset that was an asset of the debtor before commencement.

Automatic termination clauses in insolvency proceedings

221. If the insolvency law provides that a contract clause that, upon the commencement of insolvency proceedings or the occurrence of another insolvency-related event, automatically terminates any obligation under a contract or accelerates the maturity of any obligation under a contract, is unenforceable as against the insolvency representative or the debtor, the insolvency law should also provide that such provision does not render unenforceable or invalidate a contract clause relieving a creditor from an obligation to make a loan or otherwise extend credit or other financial accommodations to the benefit of the debtor.

Third-party effectiveness of a security right in insolvency proceedings

222. The insolvency law should provide that, if a security right is effective against third parties at the time of the commencement of insolvency proceedings, action may be taken after the commencement of the insolvency proceedings to continue, preserve or maintain the effectiveness against third parties of the security right to the extent and in the manner permitted under the secured transactions law.

Priority of a security right in insolvency proceedings

223. The insolvency law should provide that, if a security right is entitled to priority under law other than insolvency law, the priority continues unimpaired in insolvency proceedings except if, pursuant to insolvency law, another claim is given priority. Such exceptions should be minimal and clearly set forth in the insolvency law. This recommendation is subject to recommendation 188 of the *UNCITRAL Insolvency Guide*.

Effect of a subordination agreement in insolvency proceedings

224. The insolvency law should provide that, if a holder of a security right in an asset of the insolvency estate subordinates its priority unilaterally or by agreement in favour of any existing or future competing claimant, such subordination is binding in insolvency proceedings with respect to the debtor to the same extent that such subordination is effective under non-insolvency law..

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

225. The insolvency law should provide that the insolvency representative is entitled to recover on a first priority basis from the value of an encumbered asset reasonable costs and expenses (including overhead as appropriate) incurred by the insolvency representative in maintaining, preserving or increasing the value of the encumbered asset for the benefit of the secured creditor.

Valuation of encumbered assets in reorganization proceedings

226. The insolvency law should provide that, in determining the liquidation value of encumbered assets in reorganization proceedings, consideration should be given

to the use of those assets and the purpose of the valuation. The liquidation value of those assets may be based on their value as part of a going concern.