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Report of Working Group VI (Security Interests) on the work of its first session (New York, 20-24 May 2002)

Contents

* This document, which is based on a pre-translated text, is submitted late because it reports on a Working Group session held from 20 to 24 May 2002.

I. Introduction

1. At its present session, Working Group VI (Security Interests) began its work on the development of "an efficient legal regime for security rights in goods involved in a commercial activity …".[1]

2. The Commission's decision to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.[2]

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, para. 358.

[2] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 455, and *Fifty-sixth Session, Supplement No. 17* (A/56/17), para. 347.

3. At its thirty-third session in 2000, the Commission considered a report of the Secretary-General on possible future work in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries, and in the share such parties had in the benefits of international trade. A note of caution was struck, however, in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be co-ordinated with efforts on insolvency law.[3]

4. At its thirty-fourth session in 2001, the Commission considered a further report by the Secretariat (A/CN.9/496). At that session, the Commission agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macroeconomic benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.[4]

5. While some concerns were expressed with respect to the feasibility of work in the field of secured credit law, the Commission noted that those concerns were not widely shared and went on to consider the scope of work.[5] It was widely felt that work should focus on security interests in goods involved in a commercial activity, including inventory. It was also agreed that securities and intellectual property should not be dealt with. With respect to securities, the Commission noted the interest of the International Institute on Private Law (Unidroit). As to intellectual

[3] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 459.

[4] Ibid., *Fifty-sixth Session, Supplement No. 17* (A/56/17), para. 351.

[5] Ibid., paras. 352-354.

property, it was stated that there was less need for work in that area, the issues were extremely complex and any efforts to address them should be co-ordinated with other organizations, such as the World Intellectual Property Organization (WIPO).[6] As to the form of work, the Commission considered that a model law might be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include, where feasible, model legislative provisions.[7] After discussion, the Commission decided to entrust a working group with the task of developing an efficient legal regime for security rights in goods involved in a commercial activity, including inventory. Emphasizing the importance of the matter and the need to consult with representatives of the relevant industry and practice, the Commission recommended that a two- to three-day colloquium be held.[8] The colloquium was held in Vienna from 20 to 22 March 2002. The report of the colloquium is contained in document A/CN.9/WG.VI/WP.3.

6. The Working Group, which was composed of all States members of the Commission, held its first session in New York from 20 to 24 May 2002. The session was attended by representatives of the following States members of the Commission: Austria, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, France, Germany, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Mexico, Spain, Sweden, Thailand and United States of America.

7. The session was attended by observers from the following States: Argentina, Australia, Belarus, Cyprus, Ecuador, Indonesia, Jordan, Peru, Philippines, Poland, Portugal, Republic of Korea, Switzerland and Venezuela.

8. The session was also attended by observers from the following national or international organizations: the American Bar Association, the Association of the Bar of the City of New York (ABCNY), the Commercial Finance Association (CFA), Federación Latinoamericana de Bancos (FELABAN), the International Association of Ports and Harbors (IAPH), the International Bank for Reconstruction and Development (the World Bank), the International Chamber of Commerce, (ICC), the International Federation of Insolvency Practitioners (INSOL), the International Institute for the Unification of Private Law (UNIDROIT), the International Law Association (ILA), the International Monetary Fund (IMF), the Max-Planck Institute for Foreign and Private International Law (MPI), the National Law Centre for Inter-American Free Trade, the Union of Industrial and Employers'Confederation of Europe (UNICE) and Union Internationale des Avocats (UIA).

9. The Working Group elected the following officers:

Chairman: Ms. Kathryn Sabo (Canada);

Rapporteur: Mr. Abbas Saffarian (Islamic Republic of Iran).

10. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.1 (provisional agenda), A/CN.9/WG.VI/WP.2 and Addenda 1 through 12 (Draft legislative guide on secured transactions), A/CN.9/WG.VI/WP.3 (report on UNCITRAL-CFA international colloquium on secured transactions

[6] Ibid., paras. 354-356.
[7] Ibid., para. 357.
[8] Ibid., para. 359.

(Vienna, 20-22 March 2002)) and A/CN.9/WG.VI/WP.4 (comments by the European Bank for Reconstruction and Development).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on secured transactions.
4. Other business.
5. Adoption of the report.

II. Deliberations and decisions

12. The Working Group considered chapters I to V and X of the draft Guide. The deliberations and decisions of the Working Group are set forth below in part III. The Secretariat was requested to prepare, on the basis of those deliberations and decisions, a revised version of chapters I to V and X of the draft guide.

III. Preparation of a legislative guide on secured transactions

General remarks

13. General support was expressed for the preparation of a legislative guide on secured transactions. It was widely felt that an efficient secured transactions regime could have a positive impact on the availability of credit at affordable rates. It was also stated that the Commission's work was particularly timely as it was also preparing a legislative guide on insolvency law and could thus provide comprehensive and harmonized guidance to States. Particular emphasis was placed on the need to ensure harmony with insolvency laws, to build on texts completed by other organizations and to avoid duplication with texts currently under preparation in other organizations. In that connection, the Working Group was reminded, in particular, of the need to coordinate with Working Group V (Insolvency Law), and of the decision of the Commission not to deal with security rights in securities or intellectual property.[9] The Working Group noted that the International Institute for the Unification of Private Law (UNIDROIT) had set up a study group whose mandate was to prepare harmonized rules on the taking of security in securities, and expressed its wish that the Secretariat identify the most efficient way of coordination with UNIDROIT (see also paras. 32 and 37).

14. As to the form of work, in response to a question raised, it was noted that a model law or a convention would be too rigid, while a guide with legislative recommendations would be a more flexible and yet sufficiently useful text. It was also noted that, once the draft Guide had been completed, the Commission could consider the question of preparing a model law.

[9] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* (A/56/17), paras. 354-356.

Chapter I. Introduction

A. Organization and scope

15. While general support was expressed for the discussion in the draft Guide of the economic impact of secured transactions legislation, it was widely felt that the discussion should be stated in such a way so as not to suggest that, even though appropriate legislation was a necessary condition for a certain economic result, it was in itself sufficient to achieve that result. In that connection, it was stated that reference should be made, for example, to the appropriate infrastructure, judicial system and enforcement mechanisms necessary to ensure that a State enacting legislation based on the regime envisaged in the draft Guide ("enacting State") could obtain the economic benefits referred to in the draft Guide (i.e. increased access to credit at the appropriate credit terms and cost).

16. In addition, it was observed that the cost of establishing and applying the regime envisaged in the draft Guide should also be discussed, at least with a view to addressing concerns that some States might have. Moreover, it was said that emphasis should be placed on the potential impact of secured transactions law (e.g. priority) on insolvency law, in particular in the case of reorganization proceedings, and on the need to ensure a proper balance between the interests, on the one hand, of debtors and creditors and, on the other hand, of secured, unsecured and privileged creditors (see also para. 23).

17. The Working Group agreed that the scope of the regime envisaged in the draft Guide should be described more clearly. It was stated that work could first focus on goods, including inventory, and then possibly expand, if necessary, to other assets, such as receivables, provided that the main rules dealing with security rights in goods would not be affected. It was also observed that the more comprehensive the regime envisaged in the draft Guide, the more value it would have for legislators. The example was given of the importance of addressing enterprise mortgages that could encompass both movable and immovable property. In response, it was observed, however, that security rights in immovable property gave rise to different issues from those arising in the context of security rights in movable property and was thus treated in separate statutes. It was also said that the fact that such security rights were treated in separate statutes did not raise any problem. It was stated, however, that treating assets of an enterprise in separate statutes could raise problems of enforcement and complicate the sale of the enterprise as a going concern. In that connection, it was stated that, whether the regime envisaged in the draft Guide would apply to security rights in immovables or not, the draft Guide needed to inform enacting States of the need to ensure that the secured transactions legislation would not overlap or be in conflict with other legislation.

18. Differing views were expressed as to whether the regime envisaged in the draft Guide should cover consumer transactions. One view was that consumer transactions should be excluded altogether. It was stated, however, that, if such an approach were to be taken, it would have to be explained in the draft Guide. Another view was that consumer transactions should be addressed, provided that the rights of consumers under applicable consumer protection law would not be affected. It was observed that that result could be achieved by subjecting consumer

transactions to the same rules applicable to commercial transactions, introducing exceptions only where necessary to protect rights of consumers under consumer protection law.

19. In the discussion, the suggestion was also made that the draft Guide should discuss in more detail the problem of the cross-border recognition of security rights that were in many cases effectively lost once the encumbered assets were transported across national borders.

20. The Working Group took note of the suggestions made and, on the understanding that it might have to revisit scope-related issues in the context of its discussion of substantive issues, requested the Secretariat to address them in the next version of the draft Guide.

B. Terminology

21. It was agreed that terminology could be more usefully discussed in the context in which the substantive matters addressed in each definition arose in the draft Guide. However, several suggestions were made, including the suggestions to: limit the definition of "debtor" to commercial debtors (see para. 18); to refer in the definition of "encumbered assets" to immovable property and not only in the context of enterprise mortgages. In that connection, the concern was expressed that such an approach would result in inappropriately expanding the scope of the draft Guide (see para. 17).

C. Examples of financing practices

22. The Working Group took note of the list of examples of financing practices given in the draft Guide and agreed to consider at a later stage whether to expand that list and whether to place it in chapter I or elsewhere in the draft Guide.

Chapter II. Key objectives

23. General support was expressed for a general statement along the lines of chapter II of the main practical objectives of the regime envisaged in the draft Guide. At the same time, a number of suggestions were made including the suggestions to: refer in objective A to "fair" rather than to "full" value; refer in objective C to the value of registration systems; revise the reference in objective E to court proceedings being time-consuming, since that might not be an accurate statement of the situation prevailing in all countries and, in any case, in many countries there were expedited court proceedings; add a new objective referring to the need to protect the interests of debtors; reflect more clearly the impact of secured transactions legislation on credit discipline and corporate governance; make it clear in objective H that there were other ways to promote responsible behaviour, and not just transparency, since debtors might not wish to disclose details about their financing transactions; and to add another objective to refer to the need to protect the interests of various types of creditors (e.g. secured, unsecured and privileged creditors, within or outside insolvency proceedings, as well as to long-term and short-term creditors).

24. It was also suggested that, beyond balance between debtors and creditors, as well as among various types of creditors, balance between the various objectives should also be achieved, since, for example, simplicity might be inconsistent with transparency and speedy enforcement might be inconsistent with a balanced approach to the rights of all parties. As to party autonomy, it was also stated that it might need to be limited in a regime dealing with proprietary rights (*in rem*) that, by definition, might affect the rights of third parties. The need to consider the objectives in the light of the main financing transactions to be covered in the draft Guide was also highlighted.

25. As to registration, while it was agreed that it was a useful concept and should be discussed, it was stated that it was not an objective but rather related to the means for achieving one or more objectives. Reference was also made to studies by the Asian Development Bank, emphasizing the economic importance of registration systems, and to projects in various Asian countries aimed at the introduction of such registration systems.

26. On the understanding that it might have to revisit the key objectives in the context of its discussion of subsequent chapters, the Working Group requested the Secretariat to revise them to take into account the suggestions made and the views expressed.

Chapter III. Basic approaches to security

27. It was stated that it should be made clear right at the beginning of chapter III that it was intended to provide an indication of the various approaches to the notion of security, the advantages and disadvantages of each approach and the various policy options before legislators.

A. Pledge

28. Support was expressed for the discussion of advantages and disadvantages a pledge presented for the debtor and the secured creditor. It was observed that reference should also be made to the advantages of pledge-type security rights for third parties and, in particular, to the fact that it minimized the risk of fraud. With respect to liability of creditors in possession (for example, for contamination of the environment), it was stated that the draft Guide should discuss in more detail existing legislation exempting the creditor from liability in cases where the creditor had no effective control of the encumbered asset, and include a recommendation along those lines. It was observed that, if the creditor was not exempted from such liability, it would have to take insurance, the cost of which would be paid by the debtor and could significantly raise transaction costs.

29. In response to a question as to whether the creditor and the person holding the security right or the encumbered asset could be two different persons, it was noted that an agent or trustee could hold the right or the encumbered asset on behalf of the secured creditor, without becoming a secured creditor. It was agreed that the matter could be usefully explained in the draft Guide.

B. Right of retention of possession

30. Support was expressed for the discussion in the draft Guide of the right of retention of an asset by a party whose contractual partner failed to perform its obligations under the contract, since it was treated in some jurisdictions as a security right. However, a number of concerns were expressed with respect to the current formulation of the relevant issues in the draft Guide. One concern was that it was not sufficiently clear that a right of retention could be statutory or consensual and that the former should be excluded from the scope of the draft Guide, while the latter could be addressed. Another concern was that the right of retention, which was a contractual right even if accompanied with an authorization to a party to sell the asset, was presented as a property right. Yet another concern was that priority in payment, which was more relevant in the context of a discussion of security rights, was not discussed. Yet another concern was that the current discussion of the matter might be inadvertently understood as allowing a party to sell an asset without court authorization, where necessary.

C. Non-possessory security

31. While a discussion of non-possessory security was generally thought to be appropriate, a number of suggestions were made including the suggestions to: expand on the description of non-possessory security rights to avoid giving the impression that the debate over whether to allow non-possessory security rights was new or inconsistent with legal traditions in various civil law countries; discuss publicity as a solution to the issue of false wealth arising in the context of non-possessory security rights, but also as a tool to provide to third parties (including insolvency administrators) information on the basis of which to assess the risk of non-payment; address the question whether the secured creditor had the same rights where assets subject to an all-asset security right (global security right or "floating charge") changed; refer to the Model Inter-American Law on Secured transactions, prepared by the Organization of American States ("the OAS Model Law"), as a law covering both possessory and non-possessory security; and emphasize that treating possessory and non-possessory security rights in separate statutes could lead to inconsistencies, lack of transparency and gaps. In that connection, it was suggested that the matter needed to be discussed further as many States had asset-specific legislation with respect to non-possessory security rights.

D. Security in intangibles

32. In response to a question, it was noted that the draft Guide discussed security rights in intangibles since, in line with one of the key objectives of any efficient secured transactions system, it was based on the assumption that its scope would be as broad as possible. It was stated that, while the question of addressing security rights in some types of intangible assets should be discussed at some point of time, the Working Group should focus on security rights in goods, including inventory. It was also observed that intangibles should be discussed because of their economic value and their importance in the context of all-asset security right or enterprise mortgages. In addition, it was pointed out that intangible assets, such as receivables and proceeds of goods, needed to be given particular attention. The need to coordinate with, and complement work by, other organizations was also emphasized (see also paras. 13 and 37).

E. Transfer of title

33. It was widely felt that transfer of title was appropriately discussed in the draft Guide. At the same time, a number of suggestions were made including the suggestions to: clarify that transfer of title had been developed to circumvent the prohibition of or difficulties with non-possessory security rights and that it was not needed to the same extent in systems with modern regimes on non-possessory rights; address the question whether assets subject to a transfer-of-title security device were part of the grantor's insolvency estate; and highlight the fact that transfer of title was subject to reduced formal requirements.

F. Retention of title

34. Support was expressed for the discussion of retention of title in the draft Guide. It was stated that insolvency administrators went to great length and cost to address the question whether retention of title was a security right or not. It was, therefore, suggested that the draft Guide could make a significant contribution to practice by recommending that retention of title should be treated as a security right. However, the Working Group made no decision as to whether retention-of-title arrangements should be regarded as conditional sales or secured transactions.

G. Uniform comprehensive security

35. It was widely felt that the draft Guide should discuss both approaches taken in legal systems towards a uniform security right in all types of asset. It was stated that one approach was to abolish all existing security rights and to introduce a new one that could be created in all types of asset. As to title arrangements, it was observed that, in the context of such an approach, they could be identified and treated in the same way security rights were treated. The second approach was said to be the one currently discussed in the draft Guide, in the context of which, instead of creating a new security right, the functional equivalents of a security right were subjected to the same rules.

H. Summary and recommendations

36. The Working Group agreed that the section entitled "summary and recommendations" could be retained on the understanding that it would be restructured to form a summary and some tentative conclusions for further consideration, since it was premature at the present stage to formulate any recommendations. It was stated that it was appropriate for this chapter to set out the different security devices, their advantages and disadvantages, and the various options available to legislators. It was also observed that the chapter should be as comprehensive as possible and leave open the way in which the various approaches could be implemented. It was also stated that the draft Guide should express clear recommendations rather than focus merely on the description of existing practices.

37. As to the right of retention of possession, it was stated that reference should be made to the priority of the party having a right of retention. With respect to non-possessory security rights, it was observed that their treatment in the case of insolvency needed to be discussed in some detail. With respect to intangibles, it was pointed out that, while some types of intangibles (e.g. receivables and proceeds of

goods) should be covered, other types (e.g. securities and intellectual property rights) should not be covered in view of the need to focus on security rights in goods, the complexity of issues relating to security rights in securities, the need to use efficiently the resources of the Working Group with a view to completing its work within a reasonable period of time and the need to avoid duplication of efforts with other organizations (see also paras. 13 and 32).

38. After discussion, the Working Group requested the Secretariat to revise chapter III of the draft Guide taking into account the views expressed and the suggestions made.

Chapter IV. Creation

39. It was stated that the presentation of the contents of the chapter in the introduction was helpful for the reader and should be considered for other chapters as well. It was also observed that the types of debtors and creditors to be covered should also be discussed. Support was expressed for the principle that secured transactions would be subject to insolvency rules relating to avoidance of preferential, undervalued and fraudulent transactions.

A. Accessory nature of security right

40. It was suggested that the discussion of the principle of the accessory nature of a security right should be revised to make clear that a security right was always accessory to the secured obligation in the sense that the validity and terms of the security right depended on the validity and the terms of the secured obligation even in revolving credit transactions.

B. Obligations to be secured

41. A number of suggestions were made, including the suggestions to: revise the discussion of monetary and non-monetary obligations so as to avoid any discrimination against non-monetary obligations; clarify that a security right securing a future obligation could not be enforced, rather than have no effect, before the obligation actually arose; clarify that some modern systems required parties to set a maximum limit to the obligation to be secured, while other modern systems did not have such a requirement.

42. Differing views were expressed as to whether the draft Guide should recommend a maximum limit to the secured obligation. One view was that such a limit would make it possible for the debtor to use its assets to obtain credit from another party. It was observed that that matter was addressed in the draft Guide (fluctuating amounts and description of secured obligation) with the presentation of two options. One option was to allow for the determination of the amount of the secured obligation in a general way, and the other option was to allow an all-sums security. Another view was that the matter should be put in a practical context and the advantages and disadvantages of the various options should be discussed. It was explained that, unless the encumbered asset could be evaluated with some precision (as was the case, for example, with real property), maximum limits were not helpful. In such cases, the benefit to be derived for the debtor from making it possible for the debtor to use its assets to obtain security from another creditor

might not outweigh the benefits arising from the debtor putting no limit to the amount of the secured obligation (e.g. increased amount of credit at lower cost than otherwise). It was agreed that the matter needed to be discussed further in the context of the discussion of chapters V (A/CN.9/WG.VI/WP.2/Add.5, paras. 35-37) and VI (A/CN.9/WG.VI/WP.2/Add.6, paras. 11-12). It was also agreed that in chapter IV cross-references should be included to those chapters.

C. Assets to be encumbered

43. With respect to possible limitations, it was stated that both possible approaches should be discussed (property could not be encumbered at all or could be encumbered only up to a certain amount). It was also suggested that the draft Guide should clarify whether it was the asset that was encumbered or the right of the grantor in the asset. In that connection, it was explained that the draft Guide was based on the assumption that the security right was in the property of the grantor in the asset and not in the asset itself. It was also explained that the draft Guide discussed also the possibility of the grantor creating a security right in an asset that the grantor did not own or could not dispose of at the time of the creation of the security right (see A/CN.9/WG.VI/WP.2/Add.4, paras. 48-51). Some doubt was expressed as to whether the security right was in the right of the grantor or in the asset itself. The Working Group agreed to revisit that matter.

44. Support was expressed for allowing security to be created in assets not existing at the time of the conclusion of the security agreement ("future assets") as well as in assets acquired after the conclusion of the security agreement ("after-acquired assets"). It was also stated that a description, such as "all assets", should be sufficient.

45. With respect to security in all assets of an enterprise ("floating charge"), it was stated that it should be discussed in more detail, with particular reference to the concept of "crystallization" of the security to particular assets. It was also observed that an all-assets security was not equivalent to an enterprise mortgage, because, inter alia, the latter could include also immovable property (enforcement was subject to the same rules but not registration). With respect to the advantage of an enterprise mortgage mentioned in the draft Guide (i.e. the appointment of an administrator upon enforcement), it was observed that in practice that did not always prove to be an advantage since administrators appointed by secured creditors tended to favour secured creditors to the detriment of other creditors. It was also pointed out that recent studies in some countries had shown that enterprise mortgages might not be as advantageous as was originally thought, since banks often failed to monitor the assets and thus contribute to the preservation of a business, while they had no interests in actively participating in reorganization proceedings, since they were fully secured. After discussion, it was agreed that the relationship between an all-assets security and an enterprise mortgage should be discussed in more detail.

46. As to the issue of over-collateralization arising in some legal systems as a result of an all-assets security or an enterprise mortgage, it was stated that it should be discussed in a more balanced way to highlight both the advantages and disadvantages of an all-assets security. One advantage mentioned, for example, was the reduction of the cost of monitoring the encumbered assets. One disadvantage mentioned was that it resulted in the one-banker problem, namely that the debtor

was forced to obtain credit from only the banker to whom the debtor had given an all assets-security. In response, it was stated that that might not be a real problem since in practice there was fierce competition and the debtor could refinance its debt. On the other hand, it was observed that such refinancing had some cost. It was stated though that that cost was not the result of the all-assets security but was inherent in any refinancing. It was also observed that whether the debtor could obtain security from another party depended on the relationship between the value of its assets and the amount of the secured obligation.

D. Proceeds

47. Differing views were expressed as to whether civil fruits and proceeds could be grouped into the notion of proceeds and be subjected to the same rules. One view was that civil fruits and proceeds were two distinct notions and should not be subject to the same rules. Another view was that distinctions between these two notions were often very difficult to draw and, in any case, subjecting them to different rules could not be justified in view of the relationship between proceeds and fruits on the one hand and the original encumbered asset on the other hand. To clarify that relationship, it was said that distribution of fruits (e.g. dividends) was bound to affect the value of the original encumbered asset (e.g. stocks). To bridge the gap between the two views, it was suggested that, while terminological differences could be preserved, both proceeds and fruits should be treated as falling within the scope of the encumbered asset.

48. Recognition by the law of an automatic right of the secured creditor in proceeds was generally considered as one approach to the issue. It was stated that such a rule would function as a default rule applicable in the absence of contrary agreement of the parties. It was suggested that the other approach should also be mentioned, namely that parties could agree on extending the security right, for example, to inventory, receivables, negotiable instruments and cash. Such an approach could be taken in legal systems that allowed security to be taken in all types of asset, including future and after-acquired assets. It was explained that, in such a case, the right of the secured creditor would be a right in original encumbered assets described in the security agreement and not a right in proceeds. In response, it was stated that various approaches could be considered as long as they led to an acceptable practical result, keeping in mind that the regime envisaged in the draft Guide should include clear rules as to priority in proceeds (A/CN.9/WG.VI/WP.2/ Add.7, paras. 51-59).

49. The Working Group generally agreed that the questions mentioned in the draft Guide with respect to proceeds (A/CN.9/WG.VI/WP.2/Add.4, para. 33) were appropriately raised and requested the Secretariat to discuss possible efficient approaches, explaining the advantages and disadvantages of each approach. Particular emphasis was placed on the question whether the right in proceeds was the same as the security right (i.e. a right *in rem*) or a new right (i.e. a personal right), as well as to the time when proceeds should be "identifiable" as proceeds.

50. The concern was expressed that the reference to publicity as a way to protect third parties that relied on the proceeds as original encumbered assets might inappropriately give the impression that there were no other ways to protect third parties. In that connection, it was noted that one of the fundamental working assumptions in the draft Guide was that publicity was the most efficient way to

protect third parties, in particular in the case of non-possessory security rights. It was also noted that the mandate of the Working Group was to "develop an efficient legal regime for security rights in goods"[10] and not to collect information about and reflect all possible approaches, irrespective of whether they were generally thought to work in practice or not.

E. Security agreement

51. As to the parties to the security agreement, it was suggested that reference should be made also to the third-party security holder. That suggestion was objected to on the grounds that that third party was an agent of the secured party and had no rights of its own.

52. As to the minimum contents of the security agreement, it was stated that they should be reduced since their absence could result in an agreement being invalid. It was also said that such an approach would be in line with one of the key objectives of any efficient secured transactions regime, namely to ensure that security could be obtained in a simple and efficient manner. In particular as to the signature of the grantor, it was observed that it presupposed writing, which was not necessary in all cases. It was also said that it was not clear why the signature of the debtor was not required. Furthermore, it was said that secured creditors could be warned of the possible consequences of the absence of one of the elements mentioned from their agreements, without indirectly encouraging judges to look for grounds to invalidate such agreements.

53. While there was general agreement that formalities should be reduced to a minimum, differing views were expressed as to whether writing should be required for the security agreement to be valid. One view was that writing should not be a condition for the validity of the security agreement. It was stated that, as between the parties to the agreement, writing fulfilled a warning and an evidentiary function, while, as against third parties, writing fulfilled a fraud-prevention function. In that connection, it was observed that parties to sophisticated financing transactions did not need a warning or proof of the agreement, which could be provided by other means. As to third parties, it was pointed out that they could be protected from fraudulent ante-dating by some form of publicity. It was stated, however, that writing would be necessary, irrespective of the form of publicity. In the case of a document registry, writing was necessary since the written agreement had to be registered. In the case of a notice registry, writing was necessary, since notice did not establish the validity of the security agreement.

54. Another view was that writing should be required only for non-possessory security rights. It was observed that possession of the encumbered asset by the secured creditor was sufficient to fulfil the function that writing would fulfil (i.e. proof and prevention of fraudulent ante-dating). Yet another related view was that writing could be required as proof of the agreement not between the parties but only if it was challenged by a third party. It was stated that such an approach would be based on a clear distinction between publicity and writing, notwithstanding the third-party effects of writing.

[10] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 18*, A/55/18, para. 358.

55. Yet another view was that writing was necessary not only as between the parties to the agreement but also as against third parties. It was stated that often writing was required in particular for banking transactions and consumer transactions. It was also pointed out that, irrespective of whether the agreement needed to be in written form for it to be valid *inter partes*, it had to be in writing for execution purposes, as well as for it to be accepted as valid in the context of insolvency. It was stated, however, that, if a written form requirement was introduced, the impact in particular on informal transactions relating, for example, to retention-of-title arrangements, that were often reflected only in the seller's general terms and conditions, would have to be carefully examined. In response, it was stated that, in the absence of writing, retention-of-title arrangements were not recognized in insolvency proceedings even in countries that did not require writing for the *inter partes* validity of such transactions.

56. After discussion, the Working Group requested the Secretariat to revise the discussion of the security agreement in the draft Guide to reflect the views expressed and the suggestions made. In particular with respect to written form requirements, the Working Group requested the Secretariat to discuss the advantages and disadvantages of the various approaches, drawing, where necessary, distinctions between possessory and non-possessory security rights.

F. Other requirements for the creation of a security right

57. It was noted that, in many legal systems, the security agreement did not suffice to create a security right. Other requirements should also be met. For example, the grantor should have ownership (or some other property right) in the asset to be encumbered; in the case of a possessory security right, possession should be given to the secured creditor; in the case of a non-possessory security right in tangibles, the right should be publicized; in the case of a non-possessory security right in intangibles, control of the right should be given to the secured creditor.

58. It was suggested that the issue whether only the owner of an asset or also the holder of a lesser right could grant a security right should be discussed in more detail. In response to a question, it was explained that a creditor could acquire a security right in good faith even if the grantor was not the owner or did not have the right to dispose of the asset, provided that the creditor had extended or had made a commitment to extend credit.

59. A reservation was expressed with respect to the use of the term "possession" as it implied that a person holding an asset did so on the basis that that person was the owner of or had some other property right in the asset. In order to address that concern, it was noted that, while use of the term "possession" in English was appropriate, in other language versions reference could be made to "detention".

60. As to possession, publicity or control, it was stated that it needed to be clarified that possession was relevant only for possessory security rights, publicity was relevant for non-possessory security rights (in tangibles) and control for non-possessory security rights (in intangibles).

G. Summary and recommendations

61. It was noted that the recommendation as to the types of obligations that could be secured and the assets that could be encumbered did not deal with issues, such as

limits on the amount of the secured obligation or all-assets security rights. It was also noted that the recommendation as to rights in identifiable proceeds reflected a principle of the United Nations Convention on the Assignment of Receivables in International Trade. On that understanding, these recommendations received wide support. As to the recommendation on form requirements, it was agreed that it would be revised to reflect the discussion of the matter by the Working Group.

62. After discussion, the Working Group requested the Secretariat to revise chapter IV taking into account the views expressed and the suggestions made.

Chapter V. Publicity

A. Introduction

63. Differing views were expressed as to the need for a publicity system for security rights in movable property. One view was that such a publicity system was not necessary. In support, it was stated that, in a credit-dominated economy, parties ought to know that assets were likely to be encumbered or be subject to a quasi-security device (e.g. retention of title or lease). It was also observed that the information provided in the encumbrance registry envisaged in the draft Guide would be either too much and thus raise issues of confidentiality and competition, or too little and thus be of no use. In particular with regard to confidentiality, it was pointed out that, in order to preserve it, many countries had no general credit reporting system or property registry. If the draft Guide was to be addressed to such countries, it was said, it should discuss the advantages and disadvantages of all possible publicity systems. In addition, it was said that an encumbrance registry might be too costly to establish and operate, with the result of increased transaction costs. Moreover, it was stated that the current version of the draft Guide was not sufficiently balanced in that it did not present alternative publicity systems to registration. Alternatives mentioned included information available on balance sheets, company records or local banking systems (see A/CN.9/WG.VI/WP.2/Add.5, para. 44).

64. The prevailing view, however, was that a registry system was a crucial element of any modern and efficient secured transactions regime. It was stated that such a system replicated the publicity function of possession of an asset and was based on a universal principle of publicity and transparency. It was also observed that the system did not disclose confidential information and was beneficial to all parties concerned: debtors, because it allowed them to obtain access to credit at a cost lower and more expeditiously than in systems where information about the assets of the debtor was not readily available; creditors, because it allowed them to extend credit with relative certainty as to their rights; and third parties, because it put them on notice as to potential encumbrances in the assets of the debtor and provided an objective priority regime. In addition, it was observed that the principle of publicity and transparency had become a basic requirement in regulatory banking law to the extent that both central and commercial banks were required to do extensive credit checking with respect to borrowers. It was also pointed out that a major portion of interest rates (close to 60 per cent) was intended to cover risks arising out of lack of sufficient information on borrowers. Reference was also made to project financing and securitization practices, which were of crucial importance for the financing, in particular, of infrastructure projects and yet could not flourish in the absence of a

reliable registration system. Moreover, it was stated that absolute secrecy with respect to secured transactions meant absolute power of secured creditors over debtors, since the creditor with intimate information about a borrower with whom that creditor had a long-standing relationship effectively controlled and thus deprived that debtor of the benefits to be derived from the access to competitive banking markets.

65. While the Working Group confirmed its interest in a registry for security rights in movables, several concerns were also raised. Issues of concern mentioned included: the purpose of publicity; the scope of the registry; the cost of establishing and operating the registry; and costs for the industry to take advantage of the registry. In response, it was stated that the purpose and the scope of the registration system was set out in the draft Guide and could be discussed in detail. It was also observed that the fact that some of the least developed countries in the world had established and operated registry systems, such as the one described in the draft Guide, was a clear indication that it was cost-efficient. In that connection, it was mentioned that, in light of the advances of computer technology, registration systems could be established quickly and inexpensively and could be operated on a cost-recovery basis with nominal flat-rate, registration fees. In order to provide information necessary to address the concerns expressed, a number of suggestions were made, including the suggestions to: have a presentation of a modern registration system at the next meeting of the Working Group; and set up an informal *ad hoc* group in the context of which interested delegations could discuss practical registration-related issues.

66. In that connection, reference was made to the Convention on International Interests in Mobile Equipment (Cape Town, 2001) and the Aircraft Protocol, as well as to the OAS Model Law, which provided for publicity through the registration of limited data in a publicly accessible registry to deal with priority issues. With respect to the Convention and the Aircraft Protocol, however, it was observed that they involved a registry that was somehow different from the one envisaged in the draft Guide in that it would be international, asset-based (i.e. it would involve the identification of the encumbered asset, not the debtor, by a unique serial number) and referred only to high-value equipment. As to the OAS Model Law, it was stated that it established a registry system, such as the one envisaged in the draft Guide, which was cost-effective, comprehensive and accessible to the public and indicated the policy of the thirty-four countries participating in the OAS process to establish a dynamic, regional credit market.

67. After discussion, the Working Group decided to proceed with the examination of chapter V based on the working assumption that a publicity system, such as the one discussed in chapter V, would be part of the regime envisaged in the draft Guide.

B. Title transactions vs. security transactions

68. It was noted that the Working Group should address two key questions; first, whether transactions involving the transfer or retention of title for security purposes should be subject to registration; and second, whether certain pure title transactions should be subject to registration (e.g. long-term leases and outright assignments). A related question mentioned was whether, if certain pure title transactions were to be subject to registration, the approach to be taken should be based on an illustrative

list of transactions or on a problem-oriented concept so as to ensure that transactions in which ownership and possession were separated would be subject to registration.

69. With respect to title transactions that were functionally equivalent to secured transactions, the view was expressed that they should not be subject to registration. It was reiterated that their existence was generally known in the market and, in any case, the registry envisaged in the draft Guide provided either too much or very little information (see para. 63). It was also stated that such an approach might make it necessary for parties to true title transactions to register so as to obtain priority, a result that could inadvertently raise their cost.

70. On the other hand, the view was expressed that title transactions should be covered, at least to the extent that they served security purposes. It was stated that, if title transactions that were functionally equivalent to secured transactions were not subject to registration, the registry system could not provide reliable information as to the existence of rights that could deprive secured creditors of the asset value they would rely upon in providing credit. It was also observed that retention-of-title arrangements made practices, such as inventory financing, particularly difficult, since inventory financiers could not determine whether inventory was subject to such retention-of-title arrangements and, if so, what was the scope of such arrangements. In addition, it was said that general knowledge that there might be a retention of title was not sufficient and, in such situations, financiers would either not accept inventory as security or would accept it but add a premium to the cost of the transaction to cover for the risk that a retention-of-title holder might have priority.

71. Moreover, it was observed that, from a comparative law perspective, it was clear that a growing number of title transactions were used for security purposes and that any distinction with secured transactions would be artificial and could not be drawn. It was also said that the scope of the retention of title was also an important issue, namely whether it covered both the relevant asset and any proceeds from its sale. In that connection, it was pointed out that, even in countries that drew a distinction, retention of title was treated as a security right with respect to the proceeds of the asset that was subject to a retention of title.

72. As to pure title transactions, it was stated that they should not be subject to registration as they fell outside the scope of the secured transactions regime. In addition, it was observed that pure title transactions should not be covered by the registration system, since the purpose of a secured transactions regime could not be to establish a property registry for movables. In response, it was stated that a priority system would not be reliable unless it was comprehensive in covering all possible priority conflicts. It was noted that, in order to ensure that result, the United Nations Convention on the Assignment of Receivables in International Trade covered priority conflicts even between assignments within and outside the scope of the Convention. It was also observed that pure title arrangements should be covered by the registration systems so that an owner would have a right (not an obligation) to register and obtain priority.

73. With respect to registration of title transactions, it was stated that, if they were to be classified as secured transactions, in some countries, the following two approaches could be taken: the seller could be treated as an owner or as a

secured creditor (in the latter case, title would pass to the buyer). In either case, the seller would have to register, while the asset would be part of the insolvency estate and the seller would be given a heightened priority (even over creditors with an earlier in time filed security right; see A/CN.9/WG.VI/WP.2/Add.7, para. 20). In other countries, it was observed, a different approach was followed. If a title transaction served security purposes, the relevant asset would be part of the insolvency estate and the buyer as the owner could grant a second ranking security right. In situations where a pure title transaction was involved, the relevant asset would be separated from the insolvency estate (in liquidation proceedings). It was also stated that, from a legislative policy point of view, it would be preferable to convert title transactions to secured transactions, since, under such an approach, the rights of the buyer would be enhanced (the buyer would be treated as the owner) and the rights of the sellers could be protected through a heightened priority. In that connection, it was pointed out that the discussion of the rights of the buyer related also to a question discussed in a different context as to whether the grantor of a security right needed to have ownership or could have a lesser property right (see A/CN.9/WG.VI/I/CRP.1/Add.4, para. 12). In view of the importance of that issue, it was suggested that the relevant discussion should be placed in chapter III, dealing with the basic approaches to security.

C. Consensual vs. non-consensual security rights

74. In response to a question, it was noted that, while the focus of the Guide was on security rights created by agreement (consensual security rights), it was intended to cover all potential priority conflicts, including conflicts between consensual rights and rights created by operation of law (non-consensual rights). It was noted that the United Nations Convention on the Assignment of Receivables in International Trade had followed the same approach. It was, therefore, suggested that the definition of "security right" should be adjusted to reflect that understanding, which was also expressed at the UNCITRAL-CFA International Colloquium on Secured Transactions (see A/CN.9/WG.VI/WP.3, para. 8). In response to another question, it was stated that the term "non-consensual" was intended to cover prior preferential claims. In that connection, it was suggested that prior claims should be limited and transparent.

75. Differing views were expressed as to whether registration of a notice about a judgement by a creditor should give that creditor a right that was equivalent to a security right (see also A/CN.9/WG.VI/WP.2/Add.7, paras. 33-37). One view was that such an approach would encourage litigation or would even cause a "race to the court" by unsecured creditors and would result in the depletion of the debtor's estate to the detriment of unsecured creditors. Another view was that utilizing the registration system for collection of claims confirmed in court judgements would reduce litigation relating to execution of court judgements since, once the judgement was publicized, the debtor would pay to terminate the registration so as to be able to sell or encumber its assets.

D. Single registry vs. multiple registries

76. It was noted that the notion of a single registry referred to a single database and did not exclude multiple points from which to enter information into the

database. It was also stated that the draft Guide should emphasize that some civil law countries had long experience with asset-specific registries focusing on publicity rather than on fraudulent ante-dating. In addition, it was observed that decentralization in federal States often had to do with the federal structure of a State and might be avoided if an understanding was reached between the provinces and the federal State.

E. Notice vs. document filing

77. While support was expressed for notice filing, a number of concerns were also expressed. One concern was that it might not provide adequate information and require third parties to look outside the registry for the necessary information, which would put a burden on and risk misleading third parties. Another concern was that notice filing made it necessary for the secured creditor to summarize the security agreement in the notice, a process that was said to be prone to errors. It was observed that document filing would not raise these concerns. In response, it was pointed out that document filing raised concerns as to cost, confidentiality and error. It was also stated that a notice filing system did not present those disadvantages.

F. Timing of registration

78. It was suggested that the issue of the timing of registration in the case of insolvency should be discussed in chapter V, VII or X. It was also suggested that post-transaction registration establishing priority as of the time of the conclusion of the transaction rather than of registration should also be discussed (see exceptions to the first-to-file rule; see A/CN.9/WG.VI/WP.2/Add.7, para. 20).

G. Content of notice

79. It was suggested that the location of the assets should also be mentioned in the notice to be registered. That suggestion was objected to. It was stated that, in view of the nature of movable assets, it would be very difficult to immobilize them to a place specified in the notice. It was also observed that that matter was better left to the parties to address in their security agreement (A/CN.9/WG.VI/WP.2/Add.8). In response to a question as to whether the grantor should authorize or even sign the notice, it was noted that that matter was addressed in chapter VI (A/CN.9/WG.VI/WP.2/Add.6, paras. 15-17).

H. Coordination between general encumbrance registry and asset-specific title registries

80. It was stated that not all motor vehicle registries were title registries. It was also observed that there was no “one-size fits all” type of coordination between registries. Depending on the circumstances prevailing in a country, separate systems could be coordinated or joined in one system.

I. Registration and enforcement

81. It was stated that a distinction should be drawn between registration of notice of enforcement and registration of notice of a security right. In that connection, it was suggested that reference could be made to the OAS Model Law. It was also suggested that reference should be made to the consequences of failure to register in

the case of enforcement or insolvency proceedings, an issue that could be usefully expanded on in chapters VII (A/CN.9/WG.VI/WP.2/Add.7, paras. 43-45) and X (A/CN.9/WG.VI/WP.2/Add.10, para. 24) as well.

J. Debtor dispossession as a substitute for registration

82. Some doubt was expressed as to whether: debtor dispossession eliminated the problem of the appearance of false wealth; and the authority of the registry was reduced if, in cases where a creditor with a possessory security right relinquished possession and registered its right, the law permitted the effective date of security to relate back to the time of initial possession.

K. Third-party notice or control

83. It was noted that, in the case of a pledge of receivables, notification was considered in some legal systems as equivalent to possession. It was stated, however, that the discussion should be somehow adjusted to reflect that notification did not necessarily obligate an account debtor to pay the receivable owed. In that connection, it was observed that that obligation depended on the contract from which the receivable arose and, in particular, on whether the account debtor had any defences or rights of set-off, as well as on the payment instructions given to the debtor.

L. Third-party effects of unpublicized security rights

84. It was stated that the effects of publicity in the case of security rights in intangibles, such as receivables, needed to be further clarified.

M. Third-party effects of publicized security rights

85. It was observed that the notions of third-party effects and priority were distinct and should be further explained.

N. Summary and recommendations

86. The Working Group confirmed the universality of the principle of publicity, as reflected in paragraph 69 (A/CN.9/WG.VI/WP.2/Add.5), and decided to delete the second sentence of that paragraph.

87. After discussion, the Working Group requested the Secretariat to revise chapter V taking into account the views expressed and the suggestions made.

Chapter X. Insolvency

88. The Working Group agreed on the need to ensure, in cooperation with Working Group V (Insolvency Law), that issues relating to the treatment of security rights in insolvency proceedings would be addressed consistently with the conclusions of Working Group V on the interesection of the work of Working Group V and Working Group VI (see A/CN.9/511, paras. 126-127).

89. Various suggestions were made, including the suggestions to: refer to realization of value, rather than to enforcement as a common objective of secured credit and insolvency law; refer to stays issued at the discretion of the relevant

court; ensure the value of the security; consider whether, subject to the public policy of the forum with respect to the ranking of privileged claims and to the avoidance of fraudulent or preferential transactions, the conflict-of-laws rules applicable outside insolvency should also be applicable in an insolvency proceeding; refer to the possibility that, if in a liquidation proceeding the encumbered assets had not been sold within a reasonable period of time, the court could turn them over to the secured creditor, provided that there was a reasonable indication that the secured creditor could sell them more easily and at a better price; recognize that priviliged claims may be asserted against the encumbered assets but recommend that such claims should be limited, in number and amount, and be transparent; elaborate in the draft Guide on post-commencement financing and on the treatment of security rights in reorganization proceedings.

90. There was support in the Working Group for those suggestions. It was agreed that they should be brought to the attention of and addressed in cooperation with Working Group V.

IV. Future work

91. The Working Group noted that its second session was scheduled to take place in Vienna from 16 to 20 December 2002 and its third session was scheduled to take place in New York from 3 to 7 March 2003. It was noted that those dates were subject to the approval of the Commission at its upcoming thirty-fifth session to be held in New York from 17 to 28 June 2002.