

**General Assembly**Distr.: Limited
15 June 2004

Original: English

**United Nations Commission
on International Trade Law**
Working Group VI (Security Interests)
Sixth session
Vienna, 27 September-1 October 2004

Security Interests**Recommendations of the draft Legislative Guide on Secured
Transactions****Report of the Secretary General****Addendum****Contents**

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V. Pre-default rights and obligations of the parties

Purpose

55. The purpose of the provisions of the law on pre-default rights and obligations of the parties is to:

- (a) Provide rules on additional terms for a security agreement with a view to rendering secured transactions more efficient and predictable;
- (b) Reduce transaction costs by eliminating the need to negotiate and draft terms to be included in the security agreement where the rules provide an acceptable basis for agreement;
- (c) Reduce potential disputes;
- (d) Provide a drafting aid or check list of issues the parties may wish to address at the time of negotiation and conclusion of the security agreement; and
- (e) Encourage party autonomy.

Party autonomy

56. The law should allow the parties to waive or vary their rights and obligations unless such waiver or variation is against public policy and the protection of third parties.

Suppletive rules

57. The law should include suppletive, non mandatory rules that would apply in the absence of contrary agreement of the parties. Such rules should, inter alia:

- (a) Provide for the care of the encumbered assets by either the grantor or the secured creditor in possession of the encumbered assets;
- (b) Preserve the security rights, including the right to proceeds or civil fruits derived from the encumbered asset;
- (c) Provide for the right to use, commingle and dispose of the encumbered assets by the grantor in the ordinary course of business; and
- (d) Secure the discharge of a secured obligation once it has been performed.

VI. Default and enforcement

Purpose

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

- (a) Provide clear and simple procedures for the enforcement of security rights upon debtor default in a predictable and efficient manner;
- (b) Maximize the realization value of the encumbered assets;
- (c) Provide transactional finality upon compliance with the enforcement procedure;

(d) Define clearly the extent to which the secured creditor and the grantor may agree on the enforcement procedure;

(e) Provide that the secured creditor in enforcing its rights must act in good faith, follow commercially reasonable standards and not violate public policy; and

(f) Coordinate the enforcement rights and procedures of the secured transactions regime with the rights and procedures of other parties under other law, including insolvency law.

Notice of default and enforcement

59. [The law should:

(a) Address whether notice of the default and enforcement should be given and to whom;

(b) State the minimum contents of the notice, the manner in which it is to be given, and its timing;

(c) State that the notice should also contain the secured creditor's calculation of the amount owed as a consequence of default; and

(d) Detail the steps the debtor or the grantor may take to cure the default or recover the encumbered assets.]

Judicial and extra-judicial enforcement

60. The law should provide options to the secured creditor following default to:

(a) Resort to court or other authorities to enforce its security right; or

(b) Enforce its security right without resorting to official State institutions.

61. If the debtor, the grantor or other interested parties (e.g. a junior secured creditor, a guarantor, a co-owner of the encumbered assets, or a new secured creditor) object to actions of the secured creditor in enforcing its rights, the law should provide them with an opportunity to have judicial or administrative review of acts of the secured creditor. Safeguards should be built into the process to discourage the debtor, the grantor or other interested third parties from making unfounded claims to delay the enforcement.

Party autonomy

62. The law should permit parties to the security agreement to agree on the procedure of enforcement of security rights as between the parties, provided that the agreement conforms to the general rules of contract law and to recommendation 58 (e). The person challenging the agreement on the procedure of enforcement has the burden of showing that the agreement does not meet the foregoing requirements.

Acceptance of the encumbered assets in satisfaction of the secured obligation

63. The law should provide a procedure whereby the debtor, the grantor and the secured creditor can agree that the secured creditor will accept the encumbered

assets in full or partial satisfaction of the secured obligation. The law should provide protection for other interested parties.

Cure of default

64. Following default and until a disposition of the encumbered assets by the secured creditor, the debtor, the grantor or other interested parties should be permitted to satisfy the obligation secured by the encumbered assets by paying the outstanding secured obligation, including interest and the costs of enforcement up to the time of cure of default. The law should specify that the effect of such payment is to terminate the enforcement proceeding.

Disposition of the encumbered assets and distribution of proceeds

65. The law should provide clear rules regarding notices, where required, and procedures relating to the disposition of encumbered assets by the secured creditor and distribution of proceeds.

66. General procedures for the disposition of the encumbered assets should include the method of advertising a proposed disposition, whether disposition would take place by public auction or sale, and whether it includes the right of the secured creditor to sell, lease, license or, in the case of intangibles and negotiable instruments, collect the encumbered assets.

Collection of intangibles and negotiable instruments

67. The law should have special rules for the collection of intangibles and negotiable instruments, including the right to require the person obligated to make any payments owed to pay directly to the secured creditor.

Fixtures

68. The law should have special rules on how a secured creditor is to proceed when a single transaction includes security rights in both movable and immovable assets.

Surplus and shortfall

69. Any surplus remaining after the disposition of the encumbered assets and satisfaction of the secured obligation should be returned to the grantor, unless the secured creditor is required to distribute proceeds to other creditors. Any deficiency should be recoverable from the debtor as an unsecured claim.

Finality

70. The law should specify that, upon disposition of the encumbered assets, the rights of the grantor and the secured creditor in the encumbered assets terminate and that the buyer or other person acquiring title to the encumbered assets receives title free of any interest of the grantor, the secured creditor, and any secured creditor with a lower priority status than the secured creditor.

Coordination with other law

71. The law should be coordinated with general civil procedure law to provide a right for secured creditors to intervene in court proceedings initiated by other creditors of the grantor to protect security rights and to ensure the same priority status of claims as under the law.

Transfer of title and retention of title

72. The law should provide that the transferee of title for security purposes should be entitled to enforce its rights in the same way as any other secured creditor. [The holder of a simple retention of title should be entitled to enforce its rights [as an owner of the encumbered assets] [in the same way as any other secured creditor.]]

VII. Insolvency

[Note to the Working Group: The recommendations on insolvency will be included after the Commission has finalized the Insolvency Guide.]

VIII. Conflict of laws**Purpose**

73. The purpose of conflict of laws rules is to determine the law applicable to the creation, third party effectiveness, priority and enforcement of a security right.

Possessory security rights over tangible property

74. The law should provide that the creation, third party effectiveness and priority of a possessory security right over tangible property are governed by the law of the State in which the encumbered asset is located.

Non-possessory security right over intangible property

75. The law should provide that the creation, third party effectiveness and priority of a non-possessory security right over intangible property are governed by the law of the State in which the grantor is located.

Non-possessory security right over tangible property

76. The law should provide that the creation, third party effectiveness and priority of a non-possessory security right over tangible property are governed by the law of the State in which the encumbered asset is located, except for tangible assets ordinarily used in more than one State, in which case such issues are governed by the law of the State in which the grantor is located.

Proceeds

77. The law should provide that the conflict of laws rules applicable to proceeds are the same as the rules applicable to a security right in original encumbered assets of the same kind as the proceeds [except that the creation of a security right in

proceeds should be governed by the law applicable to the creation of the right in the original encumbered asset from which the proceeds arose].

Changes in location

78. The law should provide that the reference to the location of the assets or of the grantor in recommendations 73 to 75 refers, for creation issues, to that location at the time of the creation of the security right and, for third party effectiveness and priority issues, to that location at the time the issue arises.

79. The law should also provide that a security right made effective against third parties under the laws of the applicable State continues to be effective against third parties in another State after the location of the assets or of the grantor changes to the other State, if the requirements to make the security right effective against third parties in that other State are complied with within a specified period.

Goods in transit

80. The law should provide that a security right over [goods] [tangible property] in transit may be validly created and made effective against third parties under the law of the State of destination, provided that they are moved to that State within a certain specified time period.

No party autonomy

81. The law should provide that the parties to a security agreement cannot derogate from the rules set forth in recommendations 73 to 79.

Enforcement matters

82. The law should provide that:

Alternative A

Substantive matters affecting the enforcement of a security right are governed by the law of the State where enforcement takes place.

Alternative B

Substantive matters affecting the enforcement of a security right are governed by the law governing the priority of the right, subject however to the rules of the State where enforcement takes place that are mandatory irrespective of the law otherwise applicable.

Alternative C

Substantive matters affecting the enforcement of a security right are governed by the law governing the contractual relationship of the secured creditor and the grantor, subject however to the rules of the State where enforcement takes place that are mandatory irrespective of the law otherwise applicable.

Procedural matters

83. The law should provide that procedural matters relating to enforcement of security rights are governed by the law of the State where enforcement takes place.

Impact of insolvency on conflict rules

84. The law should provide that the occurrence of insolvency does not displace the conflict-of-laws rules applicable to the creation and third party effectiveness of a security right. With respect to priority, the law determined pursuant to the applicable conflict-of-laws rules should continue to govern, subject to the mandatory provisions of the insolvency regime of the enacting State.

Enforcement in insolvency proceedings

85. The law should provide that the insolvency law of the State in which insolvency proceedings are commenced (*lex fori concursus*) applies to all aspects of the enforcement of a security right in the insolvency proceedings (see Recs. 179-184 of the Insolvency Guide).

IX. Transition**Purpose**

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

Effective date

87. The law should specify a date, subsequent to its enactment, as of which it will enter into force (the “effective date”) in view of:

(a) The impact of the effective date on credit decisions and in particular the maximization of benefits to be derived from the law;

(b) The necessary regulatory, institutional, educational and other arrangements or infrastructure improvements to be made by the State; the status of the pre-existing law and other infrastructure;

(c) The harmonization of the law with other legislation; and

(d) The content of constitutional rules with respect to pre-effective date transactions; and standard or convenient practice for the entry into force of legislation (e.g. on the first day of a month).

Transition period

88. The law should provide a period of time after the effective date (the “transition period”), during which creditors with security rights effective against the grantor and third parties under the previous regime may take steps to assure that those rights are effective against the grantor and third parties under the law. If those steps are taken during the transition period, the law should provide that the effectiveness of the creditor’s rights against those parties is continuous.

Priority

89. The law should provide clear rules for resolving:

- (a) Which law applies to the priority between post-effective date security rights;
- (b) Which law applies to the priority between pre-effective date security rights; and
- (c) Which law applies to the priority between pre-effective date and post-effective date security rights.

90. The law should provide that priority between post-effective date security rights is governed by the law.

91. The law should provide generally that priority between pre-effective date security rights is governed by the former legal regime. The law should also provide, however, that application of those former rules will occur only if no event occurs after the effective date that would have changed the priority under the former regime. If such an event occurs, the law should determine priority.

92. With respect to priority between pre-effective date security rights and post-effective date security rights, the law should provide that it will apply as long as the holder of a pre-effective date right may, during the transition period, ensure priority under the law by taking whatever steps are necessary under the law. During the transition period, the priority of the pre-effective date right should continue as though the law had not become effective. If the appropriate steps are taken during the transition period, the holder of the pre-effective date right should have priority to the same extent as would have been the case had the law been effective at the time of the original transaction and those steps had been taken at that time.

93. When a dispute is in litigation (or a comparable dispute resolution system) at the effective date of the law, the law should specify that it does not apply to the rights and obligations of the parties.
