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Security Interests

Recommendations of the draft Legislative Guide on Secured Transactions

Note by the Secretariat

Contents

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XI. Conflict of laws*

Purpose

The purpose of conflict-of-laws rules is to determine the law applicable to each of the following issues: the creation of a security right; the pre-default rights and obligations between the secured creditor and the grantor; the effectiveness of a security right against third parties; the priority of a security right over the rights of competing claimants; and the enforcement of a security right.[1]

These rules are also applicable to: (i) rights that are not "security rights" but which are within the scope of this Guide (see recommendation 3 (f)); and (ii) in States that enact a non-unitary system with respect to acquisition financing devices, the rights of a seller or a financial lessor of goods who retains title to the goods.

Security rights in tangible property

136. The law should provide that, except as otherwise provided in recommendations 140 and 142, the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in tangible property are governed by the law of the State in which the encumbered asset is located. However, with respect to security rights in tangible property of a type ordinarily used in more than one State, the law should provide that such issues are governed by the law of the State in which the grantor is located. [With respect to security rights in the type of tangible property mentioned in the preceding sentence that is subject to a title registration system, the law should provide that such issues are governed by the law of the State under the authority of which the registry is maintained.]

[*Note to the Working Group: The commentary will explain that the application of recommendation 136 to negotiable instruments and negotiable documents is subject to the limited exception provided in recommendation 140 that the law of the grantor's location determines in specified circumstances whether the effectiveness against third parties has been achieved by registration. The commentary will also explain that recommendation 142 provides an additional option for the law governing creation and third-party effectiveness of security rights in goods in transit and export goods.*

At the eighth session of the Working Group, it was observed that the rule in the second sentence of recommendation 136 should not apply if the assets were subject to specialized registration systems (see A/CN.9/588, para. 87). Language is included in recommendation 136 within square brackets for the consideration of this matter by the Working Group. The Working Group may wish to focus on the exact description of the types of asset to which this rule should apply (e.g. ships, planes).

In addition, the Working Group may wish to consider whether a rule along the lines of recommendation 140 should apply to security rights in tangible assets covered in recommendation 136. If that approach were to be followed, if the grantor's location provided for third-party effectiveness by registration, the only law

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* Recommendations prepared in close cooperation with the Hague Conference on Private International Law.

[1] The meaning of these terms is elaborated in chapters IV, V, VI, VII and VIII.

applicable to third party-effectiveness of security rights in tangible assets other than by possession would be the law of the grantor's location and not the law of the location of the assets.]

Security rights in intangible property

137. The law should provide that the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in intangible property are governed by the law of the State in which the grantor is located. [However, with respect to security rights in intangible property that is subject to a title registration system, the law should provide that such issues are governed by the law of the State in which […].]

[*Note to the Working Group: The commentary will explain that recommendation 137, reflecting the principle in articles 22 and 30 of the United Nations Assignment Convention, applies, for example, to receivables. The second sentence within square brackets is intended to draw the attention of the Working Group to the possibility that a different law might apply to other intangible assets that are subject to title registration, such as intellectual property rights (e.g. the lex loci protectionis for patents and trademarks and the lex loci protectionis or the lex originis for copyrights).*]

Security rights in rights to proceeds from a drawing under an independent undertaking

138. [See A/CN.9/WG.VI/WP.24/Add.2.]

Security rights in bank accounts

139. Except as otherwise provided in recommendation 140, the law should provide that the creation, the effectiveness against third parties, the priority over the rights of competing claimants, the rights and duties of the depositary bank with respect to the security right and the enforcement of the security right in a bank account are governed by

Alternative A

> 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 which is engaged in the regular activity of maintaining bank accounts. The law should also specify that, if the applicable law is not determined pursuant to the preceding two sentences, the applicable law is to be determined pursuant to fallback rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

[*Note to the Working Group: Alternative A is an abbreviated version of the approach followed in articles 4.1 and 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With An Intermediary ("the Hague Securities Convention"). The commentary will include the detailed*

fallback rules in article 5 of the Hague Securities Convention with sufficient explanation.]

Alternative B

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

[*Note to the Working Group: The Working Group may wish to consider whether alternative B should address methods for identifying the branch which maintains an account.*]

Third-party effectiveness of security rights in specified types of asset by registration

140. 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 any of the following types of encumbered assets, the law of that State determines whether the effectiveness against third parties of a security right in such encumbered assets has been achieved by registration under the laws of that State:

(a) Negotiable instruments;

(b) Negotiable documents; and

(c) Bank accounts.

[*Note to the Working Group: The commentary will explain that recommendation 140 provides that the State whose law governs the achievement of third-party effectiveness by registration with respect to security rights in the specified types of assets is the same State whose law governs the achievement of third-party effectiveness with respect to security rights in intangible property. Thus, secured creditors seeking to achieve third-party effectiveness by registration for security rights in the specified types of assets and in intangible property will need to comply with the registration system of only one State. Similarly, third parties seeking to determine whether any secured creditor is claiming a security right in the specified types of assets or in intangible property will need to search in the registration system of only one State. Recommendation 140 applies only to third-party effectiveness achieved by registration (not by control or any other method) and does not determine the law governing priority. Under recommendations 61 to 66 in A/CN.9/WG.VI/WP.21/Add.1, a security right in the specified types of asset made effective against third parties by registration is subordinate to a security made effective against third parties by control or possession*.]

Security rights in proceeds

141. 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] [governing] the creation of the security right in the original encumbered asset from which the proceeds arose; and

(b) The effectiveness against third parties and the priority over the rights of competing claimants of a security right in proceeds are governed by the same law as the law [of the State whose law governs] [governing] the effectiveness against third parties and the priority over the rights of competing claimants of a security right in original encumbered assets of the same kind as the proceeds.

Security rights in goods in transit and export goods

142. The law should provide that a security right in tangible property (other than negotiable instruments or negotiable documents) 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 also be created and made effective against third parties under the law of the State of the ultimate destination, provided that the property reaches that State within a short time period of [to be specified] days after the time of creation of the security right.

[*Note to the Working Group: The commentary will explain that a security right in goods in transit and export goods can be created and made effective against third parties, under recommendation 136, in accordance with the law of the country of their location at the time of creation, or, under recommendation 142, in accordance with the law of the country of their ultimate destination. The commentary will also explain that the law of the State of the ultimate destination that governs creation and third-party effectiveness will apply even in the case of a contest with competing rights that were created and made effective against third parties while the export goods were located in the State of origin. In addition, the commentary will explain that the rule in this recommendation: (i) is applicable to encumbered assets that travel whether or not negotiable documents relating to the goods accompany the goods; (ii) is not applicable to encumbered goods that do not travel, whether or not negotiable documents relating to the goods do travel; and (iii) is not applicable to encumbered negotiable documents whether or not they travel*.]

Meaning of "location" of the grantor

143. The law should provide that, for the purposes of the recommendations in this chapter, 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

144. The law should provide that:

(a) Except as provided in paragraph (b), references to the location of the assets or of the grantor in the recommendations in this chapter refer, 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;

(b) If all rights of competing claimants in an encumbered asset arose before a change in location of the asset or the grantor, references in the recommendations in this chapter to the location of the asset or of the grantor (as relevant under the recommendations in this chapter) refer, with respect to third-party effectiveness and priority issues, to the location prior to the change in location.

Continued third-party effectiveness upon change of location

145. The law should provide that, if a security right in encumbered assets is effective against third parties under the law of the State in which the encumbered assets or the grantor (as relevant under the recommendations in this chapter) are located and that location changes to this State (i.e. the State that has enacted the law), 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 assets or the grantor (as relevant under the recommendations in this chapter) 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 at which 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.

[*Note to the Working Group: The commentary will explain that the application of the recommended provision is not based on reciprocity; i.e. it operates regardless of whether or not the State of the old location of the encumbered assets or of the grantor has enacted an equivalent provision to cover the converse situation involving the relocation of encumbered assets or a grantor to that State. The commentary will also explain that recommendation 145 will apply: (i) if the asset or the grantor moves from an enacting State or a non-enacting State to an enacting State. Recommendation 145 (or the Guide) will not apply if: (i) the asset or the grantor moves from an enacting State or a non-enacting State to a non-enacting State. Furthermore, the commentary will explain that the effect of the last sentence of this recommendation is that priority in the receiving State "relates back" to the time at which the relevant event for achieving third-party effectiveness occurred in the other State.*]

Rights and obligations of the grantor and the secured creditor

146. The law should provide that the mutual rights and obligations of the grantor and the secured creditor with respect to the security right, whether arising from the security agreement or by law, are governed by the law chosen by them and, in the absence of a choice of law, by the law governing the security agreement.

Rights and obligations of the account debtor and the assignee, the obligor under a negotiable instrument or the issuer of a negotiable document and the transferee

147. The law should provide that the following matters are governed by the law of the State whose law governs an assigned receivable, a transferred negotiable instrument or a transferred negotiable document:

(a) The relationship between an account debtor and the assignee of the receivable, between an obligor under a negotiable instrument and the transferee of that instrument or between the issuer of a negotiable document and the transferee of that document;

(b) The conditions under which the assignment of the receivable, the transfer of the negotiable instrument or the transfer of the negotiable document can be invoked against the account debtor, the obligor on the negotiable instrument or the issuer of the negotiable document; and

(c) The determination of whether the obligations of the account debtor, the obligor on the negotiable instrument or the issuer of the negotiable document have been discharged.

[*Note to the Working Group: The Working Group may wish to note that the draft Guide has both substantive and private international law recommendations with respect to the rights and obligations of a guarantor/issuer or nominated person (recs. 25bis, 25tres in A/CN.9/WG.VI/WP.24/Add.2 and 138), a depositary bank (recs. 26 in A/CN.9/WG.VI/WP.21 and 139), an account debtor in the case of an assignment of receivables (recs. 17-23 in A/CN.9/WG.VI/WP.21 and 147) and an obligor under a negotiable instrument (recs. 24 in A/CN.9/WG.VI/WP.21 and 147). The draft Guide includes also a substantive law recommendation with respect to the rights and obligations of an issuer of a negotiable instrument (rec. 109 in A/CN.9/WG.VI/WP.21/Add.2). The Working Group may wish to extend the scope of recommendation 147 to cover the relationship between the issuer of a negotiable document and a transferee of the document, as the same tri-partite relationship exists in the case of a transfer of a negotiable document and the same conflict-of-laws rule might apply.*

The Working Group may also wish to note that recommendation 3 (f) in A/CN.9/WG.VI/WP.21 provides that absolute (or outright) transfers of receivables are "generally" included. However, the definition of "receivable" in para. 21 (o) of A/CN.9/WG.VI/WP.22/Add.1 excludes rights to payment under a negotiable instrument, the obligation to pay under an independent undertaking and the obligation to pay under a bank account. As a result, absolute transfers of all those types of obligation are excluded from the scope of the draft Guide and are left to other non-secured transactions law. While this result may be appropriate with respect to obligations to pay under independent undertakings and bank accounts, which are subject to special rules and have been excluded also from the scope of the UN Assignment Convention, it may not be appropriate with respect to obligations to pay under negotiable instruments. The Working Group may wish to consider the matter and make a decision as to whether the obligation to pay under a negotiable instrument should be included, taking into account that special recommendations might need to be added in this regard.]

Enforcement of security rights

148. Except as provided in the recommendations on the law applicable to the enforcement of security rights after an insolvency proceeding has been commenced with respect to the assets of the grantor, the law should provide that matters affecting the enforcement of a security right are governed by

Alternative A

the law of the State where enforcement takes place.

Alternative B

the law governing the security agreement. However a secured creditor may take possession of tangible encumbered assets without the consent of the person in possession of them only in accordance with the law of the State in which those assets are located at the time the secured creditor takes possession of them.

Impact of insolvency on the law applicable

[*Note to the Working Group: See recommendation K and note in the recommendations of this Guide on Insolvency, A/CN.9/WG.VI/WP.21/Add.3, which read as follows: "The law should provide that, notwithstanding the commencement of an insolvency proceeding, 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 proceeding. This recommendation does not affect the application of any insolvency rules, including any rules relating to avoidance, priority or enforcement of security rights. See also recommendations 30 and 31 of the Insolvency Guide. The commentary will clarify the relation between this recommendation, on the one hand, and recommendations 30 and 31 of the Insolvency Guide on the other hand. The commentary will also explain that this recommendation refers to insolvency rules without regard to whether they are characterized as procedural, substantive, jurisdictional or otherwise.*]

Exclusion of *renvoi*

149. The law should provide that the reference in the recommendations in this chapter 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

150. The law should provide that:

(a) The application of the law determined under the recommendations of this chapter may be refused by the forum only if the effects of its application would be manifestly contrary to the public policy of the forum;

(b) A forum may apply those provisions of its own law, which, irrespective of rules of conflict of laws, must be applied even to international situations; and

(c) The rules in paragraphs (a) and (b) do not permit the application of provisions of the law of the forum to third-party effectiveness or priority among competing claimants, unless the law of the forum is the applicable law under the recommendations of this chapter.

[*Note to the Working Group: The commentary will explain the meaning of public policy and internationally mandatory rules referred to in recommendation 150. Subparagraphs (a) and (b), which track the language of article 11.1 and 11.2 of the Hague Securities Convention, have been prepared pursuant to a suggestion made at the eighth session of the Working Group (see A/CN.9/588, para. 107). Subparagraph (c), which tracks the language of article 11.3 of the Hague Securities Convention, is also in line with articles 30 to 32 of the United Nations Assignment Convention. It is intended to ensure that the certainty of*

the law applicable to third-party effectiveness and priority of a security right achieved with the recommendations in this chapter will not be compromised by application of the law of the forum.]

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

[*Note to the Working Group: The Working Group may wish to note that recommendations 151-154 are intended to provide ex ante certainty as to the application of the recommendations not only by a multi-unit State but also, most importantly, by a unitary State when the law applicable is the law of a multi-unit State. If the Working Group considers that these recommendations are too detailed for a guide, it may wish to consider whether these matters should be addressed with more general recommendations and appropriate explanations in the commentary.*]

151. The law should provide that in applying the recommendations in this chapter to situations in which the State whose law governs an issue is a multi-unit State:

(a) Subject to paragraph (b), 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;

(b) If the law in force in a territorial unit of a multi-unit State designates the law of another territorial unit of that State to govern third-party effectiveness or priority, the law of that other territorial unit governs that issue.

152. The law should provide that if, under the recommendations in this chapter, the applicable law is that of a multi-unit State or one of its territorial units, the internal choice of law rules in force in that multi-unit State shall determine whether the substantive rules of law of that multi-unit State or of a particular territorial unit of that multi-unit State shall apply.

[*Note to the Working Group: The Working Group may wish to note that recommendations 151 and 152 track the language of article 12.2 and 12.3 of the Hague Securities Convention respectively. The Working Group may wish to consider a definition of "multi-unit State" along the lines of article 1 (1) (m) of the Hague Securities Convention ("multi-unit State" means a State within which two or more territorial units of that State, or both the State and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in the recommendations in this Guide*).]

153. The law should provide that, if the account holder and the depositary bank have agreed on the law of a specified territorial unit of a multi-unit State:

(a) The references to "State" in the first sentence of recommendation 139 (alternative A) are to that territorial unit;

(b) The references to "that State" in the second sentence of recommendation 139 (alternative A) are to the multi-unit State itself.

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

(a) Under recommendation 139 (alternative A) and 153, 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 139 (alternative A); and

(c) The rule described in paragraph (b) was in force at the time the security right in the bank account was created.]

[*Note to the Working Group: Recommendations 153 and 154, which track the language of article 12.1 and 12.4 of the Hague Securities Convention respectively, may be necessary if the Working Group decides to retain alternative A in recommendation 139.*]