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Report of the Working Group on Security Interests on the work of its ninth session (New York, 30 January—3 February 2006)

Contents

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I. Introduction

1. At its present session, Working Group VI continued its work on the preparation of a legislative guide on secured transactions pursuant to a decision taken by the Commission at its thirty-fourth session, in 2001.[1] 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]

II. Organization of the session

2. The Working Group, which was composed of all States members of the Commission, held its ninth session in New York from 30 January to 3 February 2006. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Belgium, Cameroon, Canada, China, Colombia, Czech Republic, France, Germany, Guatemala, India, Iran (Islamic Republic of), Italy, Japan, Jordan, Kenya, Madagascar, Mexico, Nigeria, Pakistan, Poland, Republic of Korea, Russian Federation, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Turkey, Uganda, United States of America and Zimbabwe.

3. The session was attended by observers from the following States: Guinea, Ireland, Malaysia, Panama and Philippines.

4. The session was also attended by observers from the following international organizations:

(a) *United Nations system*: International Monetary Fund, World Bank and World Intellectual Property Organization;

(b) *Intergovernmental organizations*: European Commission;

(c) *International non-governmental organizations invited by the Commission*: American Bar Association, Center for International Legal Studies, Commercial Finance Association, Forum for International Commercial Arbitration, Independent Film & Television Alliance, International Federation of Insolvency Practitioners, International Chamber of Commerce, International Insolvency Institute, International Law Institute, International Trademark Association, International Working Group on European Security Rights, Max-Planck-Institute for Foreign and Private International Law, National Law Center for Inter-American Free Trade, the Association of European Trademark Owners, the Association of the Bar of the City of New York and the European Law Student's Association.

5. The Working Group elected the following officers:

Chairman: Ms. Kathryn SABO (Canada)
Rapporteur: Mr. Pornchai ASAWAWATTANAPORN (Thailand).

6. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.21 and Addenda 1 and 2 (Recommendations), A/CN.9/WG.VI/WP.22 (Background remarks), A/CN.9/WG.VI/WP.22/Add.1

(Introduction and key objectives) and A/CN.9/WG.VI/WP.24 and Addenda 1 to 5 (Revised recommendations).

7. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of legislative guide on secured transactions.
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

8. The Working Group considered recommendations in chapters V (Effectiveness against third parties), VI (Priority) and X (Acquisition financing). The deliberations and decisions of the Working Group are set forth below in chapter IV. The Secretariat was requested to revise the recommendations in those chapters to reflect the deliberations and decisions of the Working Group.

IV. Preparation of a legislative guide on secured transactions

Chapter V. Effectiveness of the security right against third parties (A/CN.9/WG.VI/WP.24/Add.3, recs. 35-57 ter)

Purpose

9. The Working Group approved the substance of the purpose section unchanged.

Recommendation 35 (general methods for achieving third-party effectiveness of security rights)

10. It was agreed that the words “or to be created” that appeared within square brackets in the chapeau of recommendation 35 should be deleted, since a security right that was not effective even as between the parties to the security agreement could not be effective against third parties (whether the first-registered right would have priority as of the time of registration even if it had not been created at that time was said to be a priority issue to be discussed later).

11. It was also agreed that paragraph (b) should be recast so as to focus on dispossession of the grantor rather than on delivery of possession of the assets by the grantor to the secured creditor. It was observed that, to avoid the appearance of unencumbered title on the part of the grantor, the important element was dispossession of the grantor. It was also stated that the delivery of possession could be not only by the grantor but also by another person, such as the manufacturer of goods. Furthermore, it was pointed out that delivery of possession was sufficient, if it was made not only to the secured creditor, but also to its agents or employees, or

to persons like an independent warehouseman that acknowledged that they would hold possession for the benefit of the secured creditor.

12. Moreover, it was agreed that the words "is effective only if" should be substituted for the words "becomes effective if" in order to avoid an implication that a security right might be effective as against all parties even before it was created. It was also agreed that the word "or" should be inserted after paragraph (a), indicating that paragraph (b) introduced alternative methods of achieving third-party effectiveness.

13. In the discussion, the suggestion was made that a security right, about which a notice was registered in the general security rights registry before it was created (see A/CN.9/WG.VI/WP.24/Add.3, recommendation 54), should be effective against third parties, only if it was created within a certain time period after registration. While some support was expressed for that suggestion, it was objected to on the ground that, if a security right was not created, the grantor could obtain a discharge of a registration, even through a summary proceeding (see A/CN.9/WG.VI/WP.24/Add.3, recommendation 57).

Recommendations 35 bis and 36 (special methods for achieving third-party effectiveness of security rights)

14. The Working Group agreed that recommendation 35 bis should be recast so as to separate special methods that were exclusive methods to achieve third-party effectiveness from special methods that were applicable in addition to registration in the general security rights registry. With respect to paragraph (d), the concern was expressed that the dichotomy between delivery of possession of the negotiable document and of the goods covered by the document might be problematic. The Working Group deferred discussion of that matter until it had the opportunity to consider recommendations 39 and 40 (see paras. 20 and 21 below).

15. Differing views were expressed as to whether a security right other than an acquisition security right in consumer goods should be effective against third parties automatically upon its creation. One view was that such an automatic effect would not be appropriate since the absence of transparency could have a negative impact on the availability and the cost of credit. Another view was that an automatic third-party effectiveness upon creation would be appropriate at least with respect to non-acquisition security rights in consumer goods low-value consumer goods, whose value and importance as a source of credit might not justify registration. After discussion, it was agreed that a recommendation should be included within square brackets for future consideration providing for automatic third-party effectiveness of non-acquisition security rights in low-value consumer goods that were not subject to title registration or title certificate systems.

16. The suggestion was made that recommendation 36 be deleted since it restated the obvious rule that, if different types of asset were covered in the same security agreement, different methods of achieving third-party effectiveness would be applicable. That suggestion was objected to. It was widely felt that recommendation 36 usefully clarified a matter with which many jurisdictions might be unfamiliar.

Recommendations 37 and 37 bis (third-party effectiveness of other rights)

17. While there was agreement as to the substance of recommendation 37, it was agreed that the draft Guide should state at the outset that the recommendations on security rights applied also to outright assignments and that, accordingly, references to the "grantor" also referred to the "assignor", references to the "secured creditor" also referred to the "assignee" and references to a "security right" also referred to the "right of the assignee".

18. The Working Group agreed that recommendation 37 bis should be deleted and that the commentary should discuss the possibility of extending the registration system to rights of lessors or consignors, setting forth the economic benefits to be derived from such an approach. It was widely felt that, while the commentary could address the possibility that lease or consignment law might provide that rights of lessors or consignors were subject to registration, a recommendation along the lines of 37 bis might go far beyond the scope of a secured transactions law. It was also observed that that approach was more in line with the nature of recommendation 37 bis, which was formulated as an option for States rather than as a recommendation (as indicated by the use of the verb "may" rather than the verb "should").

Recommendation 38 (third-party effectiveness of a security right in tangibles by delivery of possession to the secured creditor)

19. In line with its decision with respect to recommendation 35 (b) (see para. 3 above), the Working Group agreed that recommendation 38 should be recast so as to focus on dispossession of the grantor rather than on delivery of possession by the grantor to the secured creditor. It was also agreed that the bracketed text should be revised to explain that dispossession ought to be actual, which would be the case if the encumbered assets were in the possession of the secured creditor, an agent or employee of the secured creditor, or an independent warehouseman that had acknowledged that it retained possession on behalf of the secured creditor. It was observed that that text could be included in the appropriate place in the recommendations or the definitions, so as to apply throughout the draft Guide.

Recommendations 39 (third-party effectiveness of a security right in a negotiable document) and 40 (third-party effectiveness of a security right in goods covered by a negotiable document of title)

20. The Working Group agreed that recommendations 39 and 40 should be merged as, in practical terms, they addressed the same issue (i.e. the third-party effectiveness of a security right in a negotiable document of title and in the goods covered by the document). It was also agreed that the first sentence of recommendation 39 should be deleted as it repeated the general rule of recommendations 35 (b) and 38 that would be applicable in any case unless otherwise provided.

21. Differing views were expressed as to whether a security right in goods that were covered by a negotiable document of title should be made effective as against third parties during the time the goods were covered by the document through delivery of possession of the document only or also through delivery of possession of the goods. One view was that providing that such a security right might be made effective against third parties through delivery of possession of the goods (rather

than the document) during the time the goods were covered by the document might undermine the reliability and negotiability of the document. Another view was that such an approach would appropriately recognize delivery of possession of the goods as a method of achieving third-party effectiveness, which would be useful if there was no delivery of the document or the goods were no longer covered by the document. It was observed that such an approach would not undermine the negotiability of the document, as long as a security right that was made effective against third parties by delivery of possession of the document had priority over a security right that was made effective against third parties through delivery of possession of the goods (as was provided in A/CN.9/WG.VI/WP.24/Add.4, rec. 80). After discussion, it was agreed that the language in recommendation 40, referring to third-party effectiveness achieved during the time the goods were covered by the document through delivery of possession of the goods (rather than the document) should be placed within square brackets for future discussion of the matter by the Working Group.

Recommendation 40 bis (third-party effectiveness of a security right in movables with respect to which there is a specialized title registry or a title certificate system)

22. There was general agreement in the Working Group with the substance of recommendation 40 bis. In response to a question as to whether paragraph (c) was redundant since it repeated the general rule of recommendation 35 (a), it was observed that, in the absence of paragraph (c), it might not be clear that third-party effectiveness could be achieved by registration in the general security rights registry, unless that was made clear in recommendations 35 and 35 bis. In response to another question as to whether the methods provided in recommendation 40 bis were exclusive, it was pointed out that that matter should be left to the special legislation dealing with title registration and title certificates. In the discussion, it was stated that recommendation 40 bis might need to be adjusted to apply to security rights in intellectual property rights. The Working Group agreed that the Commission would have to decide how to deal with intellectual property rights.

Recommendation 41 (third-party effectiveness of security rights in rights to drawing proceeds from independent undertakings)

23. It was agreed that recommendation 41 (see A/CN.9/WG.VI/WP.24/Add.2, rec. 49) should be discussed together with the other recommendations dealing with security rights in rights to drawing rights from independent undertakings (see A/CN.9/WG.VI/WP.24/Add.2).

Recommendations 42-43 (third-party effectiveness of security rights in bank accounts)

24. It was agreed that paragraph (a) of recommendation 42, referring to registration of a notice in the general security rights registry, repeated the general rule of recommendation 35 (a) and should be deleted.

25. While there was general agreement in the Working Group as to the substance of recommendation 43, it was observed that the identification of the encumbered asset should be reviewed since it was not the bank account itself but rather a claim for the payment of funds in the account. The Working Group agreed that that matter

could be considered in the context of the discussion of recommendations dealing with bank accounts (see para. 88 below). The Working Group also agreed that the rights of the depositary bank, addressed in the note after recommendation 43, should also be discussed in that context.

Recommendation 44 (third-party effectiveness of security rights in proceeds)

26. A number of concerns were expressed. One concern was that automatic third-party effectiveness of security rights in proceeds of encumbered assets (i.e. without a description of the proceeds in the notice registered or registration of an additional notice once the proceeds arise) would inadvertently result in third parties not being alerted as to pre-existing security rights in cases where the proceeds were of a kind different from the original encumbered assets (e.g. the encumbered assets were inventory and the proceeds receivables). In order to address that concern, the suggestion was made that paragraph (a) should be deleted so that, under the residual rule in recommendation 44, the secured creditor would have a period within which to take any additional step necessary to make a security right in proceeds effective against third parties. There was both support for and opposition to that suggestion. In support, it was stated that, for the registry to fulfil its role of providing sufficient notice to third parties, the notice should include a reasonable description of proceeds other than money, negotiable instruments, negotiable documents or bank accounts. Otherwise, it was observed, parties would need to search outside the registry to find out possible security rights. It was also stated that automatic third-party effectiveness of security right in proceeds could eliminate competition among lenders, as the lender with a security right in the main assets of a grantor would have a security right in all assets that were proceeds of these main assets, a result that could have a negative impact on the availability and the cost of credit.

27. In opposition to that suggestion, it was observed that third parties would normally expect that assets in which they took a security right might be subject to other security rights as proceeds and would conduct a search ("due diligence") in any case to ensure that the grantor had rights in the encumbered assets. It was also pointed out that requiring an additional step to extend third-party effectiveness to security rights in proceeds would result in the secured creditor having to monitor all acts of the grantor with respect to the encumbered assets so as to make its security rights in the proceeds effective against third parties. Furthermore, it was pointed out that in cases where, for example, inventory was sold and the proceeds subsequently took the form of receivables, negotiable instruments and funds in a bank account, the normal expectation of market participants would be that the security right in all proceeds would be automatically effective against third parties without any additional step. In that connection, the suggestion was made that receivables should be added to the list of assets in paragraph (b), with respect to which a security right in proceeds was automatically effective against third parties. That suggestion received sufficient support.

28. Another concern was that paragraph (a) was not appropriate in that it treated differently registration in the general security rights registry from registration in specialized title registries, although in both cases third parties were put on notice about the possible existence of security rights. In order to address that concern, it was suggested that paragraph (a) should also include a reference to third-party

effectiveness by registration in a specialized title registry. There was sufficient support for that suggestion.

29. Yet another concern was that recommendation 44 did not make it sufficiently clear whether third-party effectiveness could be re-established if the secured creditor, having failed to take the steps necessary to make its right in the original encumbered assets or the first proceeds effective against third parties, later took all the steps necessary to make its right in subsequent proceeds effective against third parties. In order to address that concern, it was suggested that recommendation 44 should be revised to address that matter. While the view was expressed that, if third-party effectiveness had lapsed, it was permanently lost, the prevailing view was that the secured creditor could re-establish third-party effectiveness. It was widely felt that such an approach would be consistent with the rule suggested in the note after recommendation 65 (see A/CN.9/WG.VI/WP.24/Add.4), according to which priority would date back to the time when third-party effectiveness was re-established.

30. In response to a question as to whether a separate step was necessary to make effective against third parties a security right in proceeds where the security right in the original encumbered assets had been made effective against third parties by dispossession of the grantor, it was noted that, under the residual rule in recommendation 44, the secured creditor could make its right in proceeds effective against third parties by taking any steps necessary under recommendations 35 or 35 bis within a certain period of time after the proceeds arose.

31. In the discussion, it was stated that the Working Group should keep in mind the overall objective of the draft Guide to promote the availability of secured credit, in particular in developing countries and countries with economies in transition, rather than include a comparative-law analysis of national systems of developed countries.

32. After discussion, the Working Group requested the Secretariat to revise recommendation 44 presenting alternatives with regard to automatic third-party effectiveness of security rights in proceeds, taking into account the suggestions made and the views expressed.

Recommendations 45 and 46 (third-party effectiveness of security rights in fixtures)

33. A number of suggestions were made. One suggestion was that the first sentence of recommendation 45 should be deleted because it either repeated the general rule or required completion of the third-party effectiveness steps a second time after tangibles had become fixtures. That suggestion did not attract sufficient support. Another suggestion was that, for a security right in a fixture to an immovable to become effective against third parties, notice ought to be registered in the immovables registry. That suggestion was objected to. It was stated that, while the integrity of immovables registries should be preserved by appropriate priority rules, there was no reason to render a security right, with respect to which a notice had been registered in the general security rights registry, ineffective against third parties. Yet another suggestion was that recommendation 45 should be revised to make it clear that registration in the general security rights registry or, alternatively, in the immovables registry should be sufficient to make a security right effective

against third parties. There was sufficient support in the Working Group for that suggestion. As a matter of drafting, it was suggested that the reference to negotiable instruments and negotiable documents should be deleted since these types of asset could not be fixtures (see para. 92 below). After discussion, the Working Group requested the Secretariat to revise recommendation 45 taking into account the views expressed and the suggestions made.

Recommendation 46 (third-party effectiveness of security rights in masses of goods or products)

34. There was general agreement in the Working Group as to the substance of recommendation 46.

Recommendation 47 (third-party effectiveness of security rights in masses of goods or products)

35. Differing views were expressed as to whether a security right in an encumbered asset that was effective against third parties should continue to be effective when the asset became a part of a mass of goods or product. One view was that, as in the case of proceeds (see para. 27 above), no additional step should be required to preserve the effectiveness of the security right in the resulting mass or product, since the commercial expectation would be that the encumbered goods would be converted into the mass or product (e.g. as inventory was expected to be sold and converted into receivables, checks and funds in a bank account, so flour and sugar was expected to be converted into cakes). Another view was that, in the absence of an additional step to render the security interest in the mass or product effective against third parties, third parties might not have a way of knowing whether the original encumbered asset was in fact part of the mass or product. After discussion, the Working Group agreed that the recommendation be recast to reflect both alternatives for discussion at a later stage.

36. It was also agreed that the security right in the original encumbered asset that was effective against third parties did not result in a security right in the entire mass of goods or product but rather to a proportionate part of the mass of goods or product. The Working Group agreed that recommendation 47 refer to the formulation of proportionality already found in recommendation 32 in A/CN.9/WG.VI/WP.21 dealing with the creation of a security right in a mass of goods or product. Drafting suggestions made to this effect were to delete the words after the comma in the third and fourth lines and replace them with either the words "the security right thereby arising in accordance with recommendation 32 remains effective" or "that arises under recommendation 32 is effective against third parties".

Additional recommendation on third-party effectiveness of security rights in personal or property rights securing or supporting assigned receivables

37. The Working Group agreed that a new recommendation should be added to address the third-party effectiveness of a security right in personal or property rights securing or supporting assigned receivables (see A/CN.9/WG.VI/WP.21, recommendation 16 (a)).

Recommendation 48 (characteristics of a general security rights registry)

38. With respect to paragraph (a), the Working Group agreed that the words "indicating the possibility of the existence of a security right" be added in the first sentence in order to accurately reflect the position that the notice registered did not create the security right but only alerted third parties of the possible existence of a security right particularly in the case of advance registration where a notice could be registered before steps to create a security right had been concluded. It was also agreed that the word "only" in the second sentence be deleted since the information required to be reflected in the notice could change.

39. The Working Group approved paragraphs (b), (c) and (d) unchanged. In respect of paragraph (d)(i), it was agreed that the words "and publishing periodic audited statements of the expenses and revenues of the revenue of registration system" that appeared in square brackets be removed and reflected in the commentary since the level of that detail was inconsistent with the rest of the paragraph.

40. In response to a question on the relationship between paragraph (e)(i) with respect to setting of fees at a cost-recovery level and paragraph (h)(v) recommending possible delegation of the registry function to a private authority, it was agreed that there was no conflict between the two paragraphs, since a State could outsource part of the registry function (e.g. operation and maintenance of computers) to a private authority which could operate the function more effectively and that profit by a private entity did not necessarily have to translate into a cost to users. The intent of the paragraphs, it was felt, was to underscore the principle that the registry should not be operated by the State for profit purposes or as a form of indirect tax to users. It was noted that that had led to inefficiencies and decline in the use of security rights and other registries in many jurisdictions.

41. The Working Group agreed that paragraph (e)(i) be amended to reflect the principles in paragraph 40 above by adding the words "at a level no higher than" between the words "searching" and "at" in the first line. In response to a suggestion that language be added to the paragraph to reflect that fees should be as low as possible so as to reasonably provide for operation of the registry, the Working Group agreed that that matter was sufficiently covered by paragraph (a) of the purpose section of the chapter and by paragraph (e)(i) itself.

42. The Working Group approved the substance of paragraphs (e)(ii), (iii) and (iv) unchanged.

43. While there was broad support for paragraph (f)(i), the Working Group agreed that scrutiny relating to validity, sufficiency and accuracy of the notice was too narrow in scope and that the paragraph should be broadened so that no scrutiny of any kind would be necessary by any person other than the registrant. A suggestion that, in the absence of scrutiny of the notice by a registry staff, the draft Guide should provide penalties for filing false or misleading statements did not receive sufficient support. It was felt that, as a false notice had no legal effect and could be discharged under recommendation 57, the matter of penalties should be left to tort, penal or other law and should not be duplicated in the draft Guide. The Working Group agreed that the commentary reflect that position so as to provide guidance to States concerned by potential fraud and abuse of the registry system. It was also agreed that the Working Group consider expanding the scope of

recommendation 57 or the commentary to address the possibility of a grantor abusing the integrity of the registry process by filing a false release.

44. The Working Group approved the substance of paragraphs (g)(i), (ii) and (iii) unchanged. It was also agreed that the examples in paragraph (g)(iv) be moved to the commentary. In addition, the Working Group approved the substance of paragraphs (h)(i), (ii) and (iii) unchanged.

45. With respect to subparagraphs (h) (ii) and (iii), differing views were expressed. One view was that the identity of registrants should be disclosed and a copy of the registered notice should be sent to the grantor. It was stated that disclosure of the identity of the registrant could usefully limit fraudulent registrations and maintain the integrity of the registry. It was also observed that the identity of the secured creditor would be disclosed anyway in the context of payment of the registration fee on line. Furthermore, it was pointed out that, as the secured creditor could register a notice even on its own, the grantor should be informed in a timely fashion so as to be able to exercise its rights. Another view was that such requirements should be left to States that could decide on the basis of a cost-benefit analysis. It was stated that adding such requirements could inadvertently increase the cost of the system, which would have to be borne ultimately by the grantor. It was also observed that it might not always be possible to verify the identity of a registrant, particularly where independent messengers or intermediaries were used to make the registration. Furthermore, it was stated that if the obligation to send a copy of the notice to the grantor was retained, consideration should be given to specifying the consequences of failure to comply.

46. As to whether the obligation to forward a copy of the registered notice should be on the registry or the secured creditor, differing views were expressed. One view was that, in a system that was intended to limit involvement of registry staff so as to avoid costs and the possibility of errors, the secured creditor should forward the copy of the registered notice to the grantor. In addition, it was observed that, as it was in the interest of the secured creditor to ensure that a registration was made, the burden to forward a copy thereof to the grantor was better placed on the secured creditor. Another other view was that the registered notice should be sent to the grantor by the registry. It was stated that that would be easy, quick and inexpensive in the context of an electronic system. After discussion, the Working Group approved the substance of paragraphs (h) and (i) unchanged, and agreed that the issues raised be reflected in the commentary.

Recommendation 49 (required content of registered notice)

47. With respect to paragraph (a), the concern was expressed that inclusion in the notice of the name and address of the secured creditor could inadvertently provide to competitors of the secured creditor access to confidential business information. It was stated that systematic profiling of secured creditors and business relationships would be possible. In order to address that concern, it was suggested that the name and address of the secured creditor should not be included in the notice to be registered. That suggestion was objected to. It was stated that the registration system could not work if third parties were not able to contact secured creditors so as to find out about the existence and the scope of existing security rights. It was also observed that the confidentiality concerns could be satisfied by inclusion in the notice of the name of a nominee of the secured creditor instead of the name of the

secured creditor. In addition, it was stated that the concern expressed related to the ability of third parties to search in the registry using the name of the secured creditor rather than the name of the grantor, a matter that could be addressed in the commentary. In response to the point mentioned above about inclusion in the notice of the name of a nominee of the secured creditor instead of the name of the secured creditor, it was pointed out that that would not hinder profiling if the nominee was an agent of the secured creditor.

48. The Working Group agreed that where a search yielded an excessive number of potentially positive matches, supplementary identification criteria should be required. It was therefore agreed that the word "permitted" in square brackets be deleted and the word "required" be retained outside square brackets. Subject to that change, the Working Group approved the substance of recommendation 49, retaining paragraph (d) within square brackets for consideration at a later stage.

Recommendation 50 and 50 bis (legal sufficiency of grantor name in a registered notice)

49. The Working Group approved the substance of recommendations 50 and 50 bis unchanged.

Recommendation 50 ter (change in name or other identifier of the grantor)

50. The Working Group approved the substance of recommendation 50 ter unchanged.

Recommendations 51-53 (legal sufficiency of description of assets covered by a registered notice)

51. It was agreed that recommendations 51 to 53 should be revised to make it clear that the main rule was in recommendation 51, while recommendations 52 and 53 dealt with the description of generic categories of assets and after-acquired assets respectively. Subject to that change, the Working Group approved the substance of recommendations 51 to 53.

Recommendations 54 (advance registration) and 55 (one registration for multiple security agreements between the same parties)

52. The Working Group approved the substance of recommendations 54 and 55 unchanged.

Recommendation 56 and 56 bis (duration and renewal of registration)

53. The Working Group approved the substance of recommendations 56 and 56 bis unchanged. It was agreed that a new heading should be inserted for recommendation 56 bis along the following lines: "time of effectiveness of registration".

Recommendations 57 and 57 bis (discharge of registration)

54. It was agreed that, in order to address revolving credit facilities in which new advances could be made at any time before termination of the facility, termination of all lending commitments should be added to the alternative conditions of the discharge of registration listed in the chapeau of recommendation 57. It was also

agreed that, in order to avoid placing on the secured creditor the undue burden of having to constantly monitor payments and discharge registrations, paragraph (a) should be amended to provide that the secured creditor should discharge the registration within a specified time period after the request of the grantor. It was stated that, according to paragraph (b), the grantor could seek a discharge of a registration through a summary proceeding even before expiry of the deadline set out in paragraph (a). However, it was observed, in such a case, the grantor might have to bear any costs involved. It was agreed that the commentary should include a discussion of those issues. Subject to those changes, the Working Group approved the substance of recommendation 57. The Working Group approved also the substance of recommendation 57 bis unchanged.

Recommendation 57 ter (amendment of registration)

55. It was agreed that the secured creditor could seek an amendment of the registered notice at any time. It was also agreed that recommendation 57 ter should include parallel language to the language of recommendation 57 dealing with the amendment of the registered notice by the grantor (e.g. to include a narrower description of the encumbered assets). Subject to those changes, the Working Group approved the substance of recommendation 57 ter.

Additional recommendation on the registration of assignments of secured obligations

56. The suggestion was made that a new recommendation should be added to deal with the question whether, in the case of an assignment of a secured obligation, which would result in the transfer to the assignee of any rights securing the obligation, the registered notice should be amended to indicate the name of the new secured creditor. As to the contents of that recommendation, differing views were expressed. One view was that, despite the assignment, the debt was still owed and the security right remained effective against third parties without any amendment of the registered notice. Another view was that, without such an amendment, the information on record would be inaccurate, which would undermine the reliability of the registry. In response, it was observed that failure to change the name of the secured creditor should not result in a loss of third-party effectiveness, in particular as third parties would conduct searches in registries using the name of the grantor as a search criterion. After discussion, the Working Group requested the Secretariat to prepare an appropriate recommendation and place it within square brackets for future consideration of the matter by the Working Group.

57. In the discussion, the question was raised whether a recommendation should be prepared to address the question of new registration in the case of an assumption of the obligation by a person other than the grantor. In response, it was noted that as, in such a case, the debtor would change but not the grantor, no amendment of the registered notice would be required.

Chapter VI. Priority of the security right over the rights of competing claimants (A/CN.9/WG.VI/WP.24/Add.4, recs. 58-85)

Purpose

58. The Working Group approved the substance of the purpose section unchanged.

Recommendation 58 (scope of the priority rules)

59. The Working Group approved the substance of recommendation 58 unchanged.

Recommendation 59 (secured obligations affected)

60. The Working Group agreed to delete the text in parenthesis in paragraph (b) of recommendation 59 on the understanding that the commentary would clarify that future advances had the same priority as the first advance. It was also agreed that paragraph (b) should explicitly refer to future advances or other obligations. Subject to those changes, the Working Group approved the substance of recommendation 59.

Recommendation 60 (subordination agreements)

61. It was observed that recommendation 60 should be revised to permit not only a competing claimant with priority but also a competing claimant with the same priority ranking as the beneficiary of the subordination to subordinate its right to the right of another competing claimant. It was also stated that subordination should extend to an amount up to the secured claim of the beneficiary of the subordination. The Working Group approved the substance of recommendation 60 on the understanding that the commentary would include those clarifications.

Recommendations 61 and 62 (priority of security rights that are not effective against third parties)

62. The Working Group considered the question whether security rights that were not effective against third parties should nevertheless be effective against some parties. It was generally agreed that such security rights should be effective as between the grantor and the secured creditor.

63. Differing views were expressed as to whether such rights should be effective against any third party. One view was that security rights that were not effective against third parties should be effective against the general (unsecured) creditors (see recommendation 61 (c)), as well as against other secured creditors whose security rights were not effective against third parties (see recommendation 61 (b)). It was stated that, outside insolvency proceedings there was no reason not to give effect to a security right as against general creditors (with the exception of judgement creditors). It was also observed that, between two security rights that were not effective against third parties, the one that was created first should prevail.

64. However, the prevailing view was that a security right that was not effective against third parties should have no effects as against general creditors or secured creditors whose security rights were not effective against third parties. It was stated

that such an approach would be simple and consistent with the meaning of third party effectiveness adopted in the draft Guide. It was also stated that the practical result of such an approach, namely that no issue of priority would arise as between the rights of secured creditors with security rights that were not effective against third parties and that, therefore, their rights would be equal between them and with the rights of general creditors, would be appropriate and could be discussed in the commentary.

65. After discussion, the Working Group agreed that a security right that was not effective against third parties should nevertheless be effective against the grantor but not against other similar secured creditors or general creditors.

66. With respect to recommendation 62, it was widely felt that it appropriately reflected the principle that judgement creditors should have priority over secured creditors whose security rights were not effective against third parties. As a matter of drafting, it was agreed that recommendation 62 should be recast to state in a positive way that, once enforcement had begun, the secured creditor was barred from making its security right effective against third parties. It was also agreed that recommendation 62 should be coordinated with recommendation 71 which dealt with priority as between a judgement creditor and a secured creditor with a security right that was effective against third parties.

Recommendation 63 (priority of security rights that are effective against third parties)

67. Recalling its decision with respect to recommendation 35 (see para. 10 above) that a security right could not become effective against third parties before it was created (i.e. before it became effective as between the grantor and the secured creditor), the Working Group decided that the text in the note after recommendation 63 should be substituted for the first sentence of recommendation 63. It was noted that that text provided that, in the case of advance registration, priority dated back to the time of mere registration or third-party effectiveness (i.e. registration or possession and creation), whichever occurred first. It was widely felt that such an approach would facilitate and recognize advance registration, which should have a beneficial impact on the availability and the cost of credit. It was also agreed that, for the same reasons, reference should be made to registration in a specialized title registry or notation on a title certificate.

68. The suggestion was made that, if the secured creditor took possession of tangibles in advance of the creation of a security right, priority should date back to the time of delivery of possession. That suggestion was objected to. It was stated that with the exception of securities that were outside the scope of the draft Guide and negotiable instruments and negotiable documents with respect to which third-party effectiveness by possession gave a superior right, it was difficult to envisage delivery of possession of tangibles without (implicit or explicit) creation of a security right. It was also observed that, even if such situations could arise, giving retroactive priority to security rights made effective against third parties by possession, would raise uncertainty as third parties would have to follow the assets to determine whether to lend on the basis of those assets as security. After discussion, it was agreed that the matter could be raised in a note for the Working Group to consider it further to an evaluation of various practices.

Recommendation 64 (priority of a security right registered in a specialised title registry or by notation on a title certificate)

69. The Working Group approved the substance of recommendation 64 unchanged (see para. 76 below).

Recommendation 65 (continuity in priority when third-party effectiveness is achieved by more than one method)

70. The Working Group agreed that recommendation 65 should be amended to give effect to the decisions made by the Working Group with respect to recommendation 63 (see para. 67 above) by adding an appropriate reference to registration. It was also agreed that a new recommendation should be added to state that, if third-party effectiveness lapsed, priority dated as of the time third-party effectiveness was re-established.

Recommendations 66 (priority of security rights in proceeds)

71. The Working Group approved the substance of recommendation 66 unchanged.

Recommendations 67-69 (priority of rights of buyers, lessees and licensees of encumbered assets)

72. Differing views were expressed as to whether the buyer of inventory in the ordinary course of business should take free of security rights of the immediate seller only or also of persons from whom the immediate seller acquired the assets. One view was that the buyer should take free of security rights created by the immediate seller only (i.e. the bracketed language in recommendation 67 should be retained). It was stated that, if the buyer were to take free of all security rights, a bad-faith grantor could achieve the extinction of the security right by organizing two subsequent sales of the encumbered assets (i.e. from grantor A to B and from B to C, where C would take the assets free of security rights created by A).

73. The prevailing view, however, was that buyers in the ordinary course of business should take free of all security rights (i.e. the bracketed language should be deleted). It was stated that it was important to protect the reliability of ordinary course of business transactions. It was also observed that secured creditors would be protected to the extent that their security rights would extend to the proceeds from the sale of encumbered assets (and to proceeds of proceeds), which, assuming that buyers in the ordinary course of business were in good faith, would represent a reasonable price. In addition, it was pointed out that secured creditors would be protected if the sale of the encumbered assets took place outside the ordinary course of business of the seller.

74. As a matter of drafting, it was suggested that the first sentence of recommendation 67 should be recast to make it clear that it constituted the main rule, while the second sentence of recommendation 67 and recommendations 68 and 69 were exceptions to that rule. That suggestion received sufficient support.

75. After discussion, it was agreed that the bracketed language in recommendation 67 should be deleted and recommendations 67 to 69 should be revised as suggested in paragraphs 72 and 74 above. Subject to those changes, the Working Group approved the substance of recommendations 67 to 69.

Additional recommendations on the priority of rights of buyers, lessees and licensees of encumbered assets

76. It was suggested that not only security rights (see recommendation 64 and para. 69 above) but also rights of buyers, lessees or licensees of encumbered assets, registered in a specialised title registry or by notation on a title certificate should be given priority over security rights that were made effective against third parties by registration in the general security rights registry. That suggestion received sufficient support. The Secretariat was requested to prepare a recommendation.

77. It was also suggested that rights of buyers of consumer goods in good faith should be given priority over security rights in consumer goods of low value, as well as over acquisition security rights in consumer goods. It was stated that such a recommendation was necessary since security rights in consumer goods of low value and acquisition security rights in consumer goods in general were exempted from registration (see para. 15 above and A/CN.9/WG.VI/WP.24/Add.5, recommendation 128), and, as a result buyers of consumer goods, could not find out about the possible existence of any security right. It was also suggested that buyers of encumbered assets should have priority over security rights in any asset of low value. In order to address a concern expressed that such an approach might not be appropriate with respect to commercial goods, it was stated that the recommendation could be limited to consumer goods. Interest was expressed in those suggestions. The Secretariat was requested to reflect them in a note for future consideration by the Working Group.

Recommendation 70 (priority of statutory (preferential) claims)

78. The Working Group approved the substance of recommendation 70 unchanged.

Recommendation 71 (priority of rights of judgement creditors)

79. Recalling its decision with respect to recommendation 62 (see para. 66 above), the Working Group agreed that recommendation 71 should also be recast to state the rule in a positive way and be coordinated with recommendation 62. As a matter of drafting, it was suggested that recommendation 71 should refer to "the extension of credit" in general rather than to "amounts advanced" to cover loans but also open credit facilities and similar lending structures (e.g. letters of credit). In addition, it was agreed that the scope of the recommendation be extended to include a creditor that had obtained a provisional court order.

80. The suggestion was made that recommendation 71 should be revised to give priority to a secured creditor over a judgement creditor even with respect to credit extended after the issuance of a judgement on the basis of earlier-made commitments. It was stated that, in the absence of such a provision, lenders in a number of important long-term credit transactions would be reluctant to commit to extend credit in the future, whether by commitment to advance funds or to issue an independent undertaking, and if they did, they would insist that the funds be withdrawn from the facility by the grantor earlier than needed which would result in additional cost to the grantor. It was also observed that, if the secured creditor were to cease providing credit at the time it received knowledge of the judgement, it would deny the grantor liquidity or further credit at a time it was most needed and could lead to insolvency of the grantor. That suggestion was objected to. It was

observed that, after the issuance of a judgement, a lender could not expect to obtain priority over the judgement creditor on the basis of a mere commitment and should not be expected to extend credit. It was also stated that that result was obtained in practice through clauses in the loan documentation giving the lender the right to cease providing credit.

81. In the discussion, the view was expressed that the issue would be more easily resolved if the draft Guide were to provide that the notice needed to include the maximum amount secured (see A/CN.9/WG.VI/WP.24/Add.3, rec. 49 (d)), since priority of a security right could be limited to that amount, thus freeing other assets of the grantor for the benefit of other creditors, such as judgement creditors.

82. Subject to the changes referred to in paragraph 79 above, the Working Group approved the substance of recommendation 71, on the understanding that the implications discussed above would be reflected in the commentary.

Recommendation 72 (priority of rights in assets for improving and storing the assets)

83. The suggestion was made that the recommendation be deleted or at least the priority given be limited to the value added or preserved, since such a priority rule did not further the purpose of the draft Guide of promoting secured credit. After discussion, the Working Group agreed to clarify that the priority in recommendation 72 was limited to the value added or preserved.

Recommendation 73 (priority of reclamation claims)

84. The Working Group agreed that the reference to "an event specified in the sales contract" should be deleted. It was observed that, in practice, reclamation claims arose out of operation of law upon default or financial insolvency of a buyer. Subject to that change, the Working Group approved the substance of recommendation 73.

Recommendation 74 (priority of security rights in negotiable instruments)

85. The Working Group approved the substance of recommendation 74 unchanged.

Recommendation 75 (priority of security rights in rights to drawing rights from independent undertakings)

86. It was agreed that recommendation 75 (see A/CN.9/WG.VI/WP.24/Add.2, rec. 62) should be discussed together with other recommendations dealing with security rights in rights to drawing rights from independent undertakings (see A/CN.9/WG.VI/WP.24/Add.2).

Recommendation 76 to 78 (priority of security rights in bank accounts)

87. A number of concerns were expressed. One concern was that recommendation 76 did not address priority conflicts between a security right in a bank account made effective against third parties by control and a security right in the same account made effective against third parties by any other method (e.g. in the bank account as proceeds). In order to address that concern, it was suggested that a right made effective against third parties by control should have priority over

a right made effective against third parties by any other method. That suggestion attracted sufficient support.

88. Another concern was that the encumbered asset was not the bank account itself but the right to claim the funds in the bank account. In order to address that concern, the suggestion was made that the definition of "bank account" should be revised. Yet another concern was that the term "control" was misleading, since it suggested physical possession. With respect to the definition of "control" (see A/CN.9/WG.VI/WP.24/Add.3, note after recommendation 42), the concern was expressed that many countries would not be able to implement it and the priority rules based on it, for example, because, under banking law, a bank was precluded from accepting instructions with respect to an account from any person other than the holder of the account and a bank account would not be transferred to the secured creditor but the funds in that account would be transferred to an account of the secured creditor. To address those concerns, the suggestion was made that the definitions of "bank account" and "control" should be revised to address the concerns raised. That suggestion received sufficient support.

89. With respect to recommendation 77, it was agreed that reference should be made to the right of set-off not being impaired by a security right and not being available unless created by other law.

90. Subject to the changes mentioned above (see paras. 87-89), the Working Group approved the substance of recommendations 76 to 78.

Recommendations 79 (priority of security rights in money) and 80-81 (priority of security rights in negotiable documents and goods covered by negotiable documents)

91. The Working Group approved the substance of recommendations 79 to 81 unchanged.

Recommendations 82-84 (priority of security rights in fixtures)

92. A number of suggestions were made. One suggestion was that recommendations 82 and 83 should refer to rights of buyers, lessees and other parties with a right in fixtures to immovables. Another suggestion was that the language of recommendations 82 and 83 should be aligned so that both referred to registration in the immovables registry. Yet another suggestion was that recommendation 83 should be retained without square brackets and the words in parenthesis should be deleted (see para. 33 above). Subject to those changes, the Working Group approved the substance of recommendations 82 and 83. As to recommendation 84, it was agreed that it should be deleted as it repeated the general rule.

Recommendation 85 (priority of security rights in masses of goods or products)

93. It was agreed that paragraph (a) should be retained as a separate recommendation dealing with security rights in fixtures to movables with respect to which there was a specialized registration or title certificate system. With respect to paragraph (b), it was agreed that the commentary should set forth examples of priority rules so as to provide guidance to States. It was also agreed that the commentary should discuss issues of characterization, for example, of security

rights in rents or crops, which in some jurisdictions were subject to the regime on movables, while in other jurisdictions were subject to the regime on immovables.

Chapter X. Acquisition financing devices (A/CN.9/WG.VI/WP.24/Add.5, recs. 125-135)

94. Due to the lack of sufficient time, the Working Group decided to consider only recommendations 133 and 134.

Recommendation 133 (priority of acquisition security rights in proceeds of inventory)

95. The Working Group considered the bracketed text in recommendation 133 (unitary and non-unitary approach), according to which the super-priority of an acquisition security right in proceeds would not extend to proceeds in the form of receivables. Differing views were expressed. After discussion, it was agreed that the bracketed text in recommendation 133 should be retained within square brackets.

Recommendation 134 (enforcement)

96. There was support for both the unitary and the non-unitary approach. As to the alternative ways to implement the non-unitary approach, there was both support and criticism of both alternatives. The need to preserve the functional equivalence between the various devices was particularly emphasized. At the same time, there was support for preserving the flexibility of States in implementing the non-unitary approach. The Working Group approved the substance of recommendation 134 (unitary approach) unchanged. As to the alternatives reflected in recommendation 134 (non-unitary approach), the Working Group agreed that they should be retained. It was also agreed that the commentary should be further developed to explain in some detail the ways in which these alternatives could be implemented and their specific implications.

V. Future work

97. In view of the expectation of the Commission to approve in principle the substance of the recommendations of the draft Guide at its thirty-ninth session, which was scheduled to take place in New York from 19 June to 7 July 2006, the Working Group agreed to hold an extra session, its tenth session, in New York from 1 to 5 May 2006. The Working Group noted that its eleventh session would take place in Vienna from 4 to 8 December 2006, those dates being subject to approval by the Commission at its thirty-ninth session.

Notes

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 358. For a history of the project, see A/CN.9/WG.VI/WP.22. The reports of the first to the seventh sessions of the Working Group are contained in documents A/CN.9/512, A/CN.9/531, A/CN.9/532, A/CN.9/543 and A/CN.9/549,

A/CN.9/570 and A/CN.9/574. The reports of the first and the second joint sessions of Working Group V (Insolvency Law) and VI (Security Interests) are contained in documents A/CN.9/535 and A/CN.9/550. The consideration of those reports by the Commission is reflected in documents A/57/17 (paras. 202-204), A/58/17 (paras. 217-222), A/59/17 (paras. 75-78) and A/60/17 (paras. 185-187).

[2] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 455, and *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 347.