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Security Interests

Draft Legislative Guide on Secured Transactions

Security rights in negotiable instruments: definitions and recommendations

Note by the Secretariat

Addendum

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Security rights in negotiable instruments

I. Definitions (A/CN.9/WG.VI/WP.22/Add.1, para. 21 (i), (o) and (w))

(i) “Tangibles” means all forms of corporeal movable property. Among the categories of tangibles are inventory, equipment, fixtures, negotiable instruments and negotiable documents.

(o) “Receivable” means a right to the payment of a monetary obligation, excluding, however, rights to payment evidenced by a negotiable instrument, the obligation to pay under an independent undertaking and the obligation of a bank to payment of funds credited to a bank account.

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

[Note to the Working Group: The Working Group may wish to note that the commentary will clarify that the phrase “law governing negotiable instruments”, or law governing negotiable documents” or similar expression are intended to encompass all law that applies to negotiable instruments or negotiable documents, including not only negotiable instrument or negotiable document law as such but also bailment law, contract law and other law that might be applicable. Other applicable law might include in particular specialized laws that relate to obligors or negotiable instruments or to issuers of negotiable documents or to particular types of goods that might be covered by a negotiable document. Throughout the draft Guide, the term “law” is intended to include both statutory and non-statutory law.]

II. Recommendations

Parties, security rights, secured obligations and assets covered (see A/CN.9/WG.VI/WP.21, recs. 3 (d) and 16)

3. In particular, the law should provide that it applies to:

(d) All types of movable assets and fixtures, tangible or intangible, present or future, not specifically excluded in the law, including inventory, equipment and other goods, receivables, negotiable instruments (such as cheques, bills of exchange and promissory notes), negotiable documents (such as bills of lading),] rights to payment of funds credited to bank accounts, rights to drawing proceeds from an independent undertakings, and intellectual property rights;

[See A/CN.9/WG.VI/WP.26, rec. 16 and Note to the Working Group.]

Creation of a security right in a negotiable instrument

[Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.21), a security right in a negotiable instrument may be created by a written and possibly signed agreement between the grantor and the secured creditor or by even an oral agreement and delivery of possession of the instrument to the secured creditor. The commentary will also explain that creation of a security

right or transfer of a negotiable instrument by endorsement under negotiable instrument law would not be affected by this recommendation.]

**Creation of a security right in a right that secures a negotiable instrument
(see A/CN.9/WG.VI/WP.21, rec. 24)**

24. The law should provide that, if a security right has been effectively created in a negotiable instrument, the secured creditor also has a security right in accessory rights with respect to the negotiable instrument without a new act of transfer. Such accessory rights may include:

- (a) Rights against guarantors with respect to the negotiable instrument; and
- (b) Security rights securing the obligation of the obligor on the negotiable instrument.]

[Note to the Working Group: The Working Group may wish to note that, under recommendation 24, if A gets a note from B guaranteed by C and then grants a security right in the note to D, D gets a security right in the guarantee as well. As the matter is addressed in recommendation 16, the Working Group may wish to consider deleting recommendation 24 and placing the examples in the commentary.]

Rights and obligations of the obligor under a negotiable instrument

[Note to the Working Group: The Working Group may wish to consider whether language along the following lines should be included here to address the rights and obligations of the obligor under a negotiable instrument:

“The law should provide that as between the secured creditor and (i) the person obligated on the negotiable instrument, or (ii) other persons claiming rights under the law governing negotiable instruments, the obligations and rights of those persons are determined by the law governing negotiable instruments.” This text is drawn from recommendation 104 (see rec. 104 below.)

**Third-party effectiveness of a security right in a negotiable instrument
(see A/CN.9/WG.VI/WP.24/Add.3)**

[Note to the Working Group: The Working Group may wish to note that the commentary will explain that, according to the general third-party effectiveness recommendation 35, a security right in a negotiable instrument may be made effective against third parties by registration of a notice in the general security rights registry or by dispossession of the grantor.

The Working Group may also wish to include an additional recommendation along the following lines:

“The law should provide that where a security right in a negotiable instrument is effective against third parties, the security right continues to be effective against third parties for a short period of [to be specified] days after the negotiable instrument has been relinquished to the grantor for the purpose of presentation, collection, enforcement, renewal.”]

Priority of a security right in a negotiable instrument
(see A/CN.9/WG.VI/WP.24/Add.4, rec. 74)

74. The law should provide that a security right in a negotiable instrument that has been made effective against third parties by dispossession of the grantor with respect to the instrument has priority over a security right in a negotiable instrument that was made effective against third parties by any other method. The law should also provide that a security right in a negotiable instrument that has been made effective against third parties by a method other than by dispossession of the grantor with respect to the instrument is subordinate to the rights of a buyer, another secured creditor or other transferee in a consensual transaction that either:

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

(b) Takes possession of the negotiable instrument and gives value in good faith and without knowledge that the transfer was in violation of the rights of the holder of the security right.

[Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general priority recommendations apply to priority with respect to security rights in negotiable instruments, while recommendation 74 deals with additional priority conflicts.]

Enforcement of a security right in a negotiable instrument
(A/CN.9/WG.VI/WP.24/Add.1, recs. 104 and 105)

104. The law should provide that after default or before default with the agreement of the obligor of the negotiable instrument the secured creditor has the right to collect or otherwise enforce a negotiable instrument that is an encumbered asset against a person obligated on that instrument.

[Note to the Working Group: The commentary will explain that as between the secured creditor and (i) the person obligated on the negotiable instrument, or (ii) other persons claiming rights under the law governing negotiable instruments, the obligations and rights of those persons are determined by the law governing negotiable instruments. The commentary will also include the following examples of such persons:

(a) The person obligated on the negotiable instrument may be obligated to pay only a holder or other person entitled to enforce the instrument under the law governing negotiable instruments; and

(b) The right of the person obligated on the instrument to raise defences to that obligation is determined by the law governing negotiable instruments.]

105. The law should provide that the secured creditor's right to collect or otherwise enforce a negotiable instrument includes the right to collect or otherwise enforce any personal or property right that secures payment of the negotiable instrument (such as a guarantee or security right).

Law applicable to security rights in tangibles (A/CN.9/WG.VI/WP.24, rec. 136)

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 “tangible property of a type ordinarily used in more than one State” refers to mobile goods, such as motor vehicles.]

Law applicable to third-party effectiveness of security rights in specified types of asset by registration (A/CN.9/WG.VI/WP.24, rec. 140)

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 negotiable instruments, negotiable documents and rights to payment of funds credited to bank accounts, 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.

Law applicable to rights and obligations of the grantor and the secured creditor (A/CN.9/WG.VI/WP.24, rec. 146)

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.

Law applicable to the 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 secured creditor (A/CN.9/WG.VI/WP.24, rec. 147)

147. The law should provide that the following matters are governed by the law of the State whose law governs an assigned receivable, or a negotiable instrument or a negotiable document in which a security right has been created:

(a) The relationship between an account debtor and an assignee of the receivable, between an obligor under a negotiable instrument and a creditor with a security right in that instrument or between an issuer of a negotiable document and a creditor with a security right in 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 extension of the scope of the Guide to outright transfers of negotiable instruments is addressed in the Note tot the Working Group after recommendation 3(f) in A/CN.9/WG.VI/WP.26). The Working Group may wish to note that the commentary will explain that: (i) recommendation 148 applies to the enforcement of a security right in a negotiable instrument (A/CN.9/WG.VI/WP.24); and (ii) the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in negotiable instruments.]
