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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) and (x))

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

(x) “Negotiable document” means a document that embodies a right for delivery of tangibles, such as a warehouse receipt or a bill of lading, which satisfies the requirements for negotiability under the law governing negotiable documents.

(pp) “Possession” means the actual possession of tangibles by the secured creditor, or an agent, employee or other person holding on behalf of the secured creditor, or an independent person who acknowledges that it holds for the secured creditor. It does not include constructive, fictive or symbolic possession.

II. Recommendations

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

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;

Creation of a security right in a negotiable document (see A/CN.9/WG.VI/WP.21, rec. 28)

[Note to the Working Group: The Working Group may wish to note that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.21), a security right in a negotiable document may be created by a written and possibly signed agreement between the grantor and the secured creditor or even by an oral agreement and delivery of possession of the document to the secured creditor. The Working Group may wish to consider whether this rule should be stated explicitly in a recommendation.]

28. The law should provide that the creation of a security right in a negotiable document also gives rise to a security right in the goods represented by the document, provided that the issuer is in possession of the goods at the time the security right in the document is created.

[Note to the Working Group: The Working Group may wish to note that the commentary will clarify that recommendation 28 is intended to negate that a separate security right needs to be created in the goods.]

Rights and obligations of the issuer of a negotiable document

[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 issuer of a negotiable document:]

“The law should provide that as between the secured creditor and the issuer or other person obligated on the negotiable document, the rights and obligations of those persons are determined by the law governing negotiable documents.” This text is drawn from recommendation 109 (see rec. 109 below).]

Third-party effectiveness of a security right in a negotiable document (see A/CN.9/WG.VI/WP.24/Add.3, rec. 39)

44. The law should provide that, if a security right in a negotiable document is effective against third parties, the corresponding security right in the goods covered by the document is also effective against third parties. The law should also provide that, as long as a negotiable document covers goods, a security right in the goods may be made effective against third parties [only] by dispossession of the grantor with respect to the document [or with respect to the goods].

[Note to the Working Group: The Working Group may wish to recall that the language in square brackets indicates a difference of opinion in the Working Group as to whether allowing alternative methods of achieving third-party effectiveness of a security right in goods covered by a negotiable document undermines the negotiability of the document or the matter can be addressed by giving priority to a right in goods made effective against third parties by dispossession of the grantor with respect to the document (see A/CN.9/593, para. 21); see also A/CN.9/WG.VI/WP.26/Add.3, rec. 80.]

[44 bis. The law should provide that a security right in a negotiable document that is effective against third parties remains effective against third parties for a short period of [to be specified] days after the negotiable document has been relinquished to the grantor for the purpose of ultimate sale or exchange, loading or unloading, or otherwise dealing with the goods covered by the negotiable document.]

Priority of security rights in negotiable documents (A/CN.9/WG.VI/WP.24/Add.4, recs. 80 and 81)

80. The law should provide that, while goods are in the possession of the issuer of a negotiable document with respect to them, a security right in those goods that became effective against third parties as a result of the security right in the negotiable document becoming effective against third parties has priority over another security right in the goods that was made effective against third parties by a different method while the goods were covered by the document.

81. The law should provide that a security right in a negotiable document and the goods covered thereby is subject to the rights under the law governing negotiable documents of a person to whom the negotiable document has been duly negotiated.

[Note to the Working Group: The Working Group may wish to note that the commentary will clarify that the general priority recommendations apply to security

rights in negotiable documents, while recommendations 80 and 81 deal with additional priority conflicts.]

**Enforcement of a security right in a negotiable document
(A/CN.9/WG.VI/WP.24/Add.1, rec. 109)**

109. The law should provide that after default or before default with the agreement of the issuer of the negotiable document the secured creditor has the right to enforce a negotiable document against the issuer or any other person obligated on the negotiable document. However, as between the secured creditor and the issuer or other person obligated on the negotiable document, the rights and obligations of those persons are determined by the law governing negotiable documents.

[Note to the Working Group: The Working Group may wish to note that the commentary will include the example that the issuer may be obligated to deliver the goods only to a holder of the negotiable document with respect to them. The commentary will also explain that the general recommendations on enforcement of security rights apply here as well, while recommendation 109 deals with a special issue.]

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 commentary will explain that: (i) recommendation 148 applies to the enforcement of a security right in a negotiable document (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 documents.]
