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Report of Working Group VI (Security Interests) on the work of its twenty-sixth session (Vienna, 8-12 December 2014)

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I. Introduction

1. At its present session, Working Group VI (Security Interests) continued its work on the preparation of a model law on secured transactions (the "draft Model Law"), pursuant to a decision taken by the Commission at its forty-fifth session (New York, 25 June-6 July 2012).[1] At that session, the Commission agreed that, upon its completion of the UNCITRAL Guide on the Implementation of a Security Rights Registry (the "Registry Guide"), the Working Group should undertake work to prepare a simple, short and concise model law on secured transactions based on the general recommendations of the UNCITRAL Legislative Guide on Secured Transactions (the "Secured Transactions Guide") and consistent with all texts prepared by UNCITRAL on secured transactions, including the United Nations Convention on the Assignment of Receivables in International Trade (the "Assignment Convention"), the Supplement on Security Rights in Intellectual Property (the "Intellectual Property Supplement") and the Registry Guide.[2]

2. At its twenty-third session (New York, 8-12 April 2013), the Working Group had a general exchange of views on the basis of a note prepared by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.55 and Add.1 to 4).

3. At its forty-sixth session (Vienna, 8-26 July 2013), the Commission agreed that the preparation of the draft Model Law was an extremely important project to complement the work of the Commission in the area of security interests and provide urgently needed guidance to States as to how to implement the recommendations of the Secured Transactions Guide. It was also agreed that, in view of the importance of modern secured transactions law for the availability and the cost of credit, and the importance of credit for economic development, such guidance was extremely important and urgent to all States at a time of economic crisis but in particular to States with developing economies and economies in transition. In addition, it was stated that the scope of the draft Model Law should include all economically valuable assets.[3] After discussion, the Commission confirmed the mandate it had given to Working Group VI in 2012 (see para. 1 above).[4] The Commission also agreed that whether that work would include security interests in non-intermediated securities would be assessed at a future time.[5]

4. At its twenty-fourth session (Vienna, 2-6 December 2013), the Working Group considered a note by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.57 and Add.1 and 2) and requested the Secretariat to revise the draft Model Law to reflect the deliberations and decisions of the Working Group (A/CN.9/796, para. 11). At its twenty-fifth session (New York, 31 March-4 April 2014), the Working Group continued its work based on a note by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.57/Add.2-4 and A/CN.9/WG.VI/WP.59 and Add.1) and

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[1] *Official Records of the General Assembly, Sixty-seventh Session, Supplement No. 17* (A/67/17), para. 105.

[2] Ibid.

[3] Ibid., *Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 193.

[4] Ibid., para. 194.

[5] Ibid., para. 332.

requested the Secretariat to revise the draft Model Law to reflect the deliberations and decisions of the Working Group (see A/CN.9/802, para. 11). At that session, the Working Group also decided to recommend to the Commission that the draft Model Law address security rights in non-intermediated securities along the lines agreed upon by the Working Group at that session (see A/CN.9/802, para. 93).

5. At its forty-seventh session (New York, 7-18 July 2014), the Commission expressed its satisfaction for the considerable progress achieved by the Working Group in its work and requested the Working Group to expedite its work so as to complete the draft Model Law, including certain definitions and provisions on non-intermediated securities (see A/CN.9/811), and to submit it to the Commission for adoption together with a guide to enactment as soon as possible.[6]

II. Organization of the session

6. The Working Group, which was composed of all States members of the Commission, held its twenty-sixth session in Vienna from 8 to 12 December 2014. The session was attended by representatives of the following States members of the Working Group: Armenia, Austria, Canada, China, Colombia, Croatia, France, Germany, Indonesia, Israel, Italy, Japan, Malaysia, Mexico, Nigeria, Panama, Philippines, Poland, Republic of Korea, Russian Federation, Spain, Switzerland, Thailand, Turkey, United Kingdom of Great Britain and Northern Island, United States of America and Venezuela (Bolivarian Republic of).

7. The session was attended by observers from the following States: Bolivia (Plurinational State of), Burkina Faso, Chile, Congo, Cyprus, Czech Republic, Dominican Republic, Libya, Peru, Qatar and Romania. The session was also attended by an observer from the European Union.

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

(a) *United Nations system*: World Bank; and

(b) *International non-governmental organizations invited by the Commission*: American Bar Association (ABA), Asociación Interamericana de Derecho Internacional Privado (ASADIP), Commercial Finance Association (CFA), European Federation for Factoring and Commercial Finance (EUF), European Law Students' Association (ELSA), Factors Chain International (FCI), Forum for International Conciliation and Arbitration (FICACIC), International Factors Group (IFG), International Insolvency Institute (III), Law Association for Asia and the Pacific (LAWASIA), Moot Alumni Association (MAA) and National Law Centre for Inter-American Free Trade (NLCIFT).

9. The Working Group elected the following officers:

Chairperson: Ms. Kathryn SABO (Canada)

Rapporteur: Ms. Fazlina PAWAN TEH (Malaysia)

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[6] Ibid., *Sixty-ninth Session, Supplement No. 17* (A/69/17), para. 163.

10. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.60 (Annotated Provisional Agenda) and A/CN.9/WG.VI/WP.61 and Add.1-3 (Draft Model Law on Secured Transactions).

11. 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. Draft Model Law on Secured Transactions.
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

12. The Working Group considered a note by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.61 and Add.1-3). The deliberations and decisions of the Working Group are set forth below in chapter IV. The Secretariat was requested to revise the draft Model Law to reflect the deliberations and decisions of the Working Group.

IV. Draft Model Law on Secured Transactions

A. Chapter I. Scope of application and general provisions (A/CN.9/WG.VI/WP.61)

Article 1. Scope of application

13. With respect to paragraph 1, the Working Group agreed that, to avoid repeating the essence of the definition of the term "security right", which was contained in article 2, subparagraph (ii), it should be revised to refer to security rights in movable assets as defined in article 2, subparagraph (ii). It was also agreed that the term "movable asset" could be elaborated in the Guide to Enactment.

14. The Working Group next proceeded to consider the definition of the term "security right". A number of drafting suggestions were made. One suggestion was that, to better reflect the functional approach of the draft Model Law ("substance over form"), the definition should be revised to read along the following lines "… an agreement to secure payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right or not, the type of asset, the status of the grantor or the secured creditor, or the nature of the secured obligation". While there was support for that suggestion, it was also suggested that, for reasons of consistency, a noun should be used to refer to the "denomination of the right as a security right". That suggestion was objected to on the ground that the term "denomination" might be misleading. Another suggestion was that, to avoid inadvertently excluding security rights that might not be considered as falling under the category of property rights in some jurisdictions, the reference to a security right

as a property right should be deleted. That suggestion was also objected to on the ground that the reference to a security right as a property right (i.e. a right in rem) was necessary to exclude personal security rights (i.e. a right ad personam such as a guarantee). In that connection, it was suggested that the reference in article 11, paragraphs 1 and 2, to personal or property rights securing payment or other performance of a receivable should be clarified. Yet another suggestion was that the words "for convenience of reference" should be deleted as it was sufficiently clear that the term "security right" included the right of the transferee in an outright transfer of a receivable for convenience of reference and thus those words were inappropriate in a model law. There was sufficient support for that suggestion.

15. With respect to paragraph 2, the suggestion was made that, to avoid repeating that the draft Model Law applied to outright transfers of receivables, it should be recast to refer to the fact that articles 81-94 of the draft Model Law did not apply to such transfers. While there was agreement as to the thrust of that suggestion, it was agreed that, in its current formulation, paragraph 2 emphasized an important and novel point that was worth repeating and thus paragraph 2 should be retained unchanged.

16. With respect to subparagraph 3(a), a number of suggestions were made. One suggestion was that it should include a reference to article 11, paragraph 2, which provided for the extension of a security right in a receivable to a right to receive the proceeds under an independent undertaking that secured the payment or other performance of the receivable. Another suggestion was that the right to receive the proceeds under an independent undertaking should not be excluded from the scope of the draft Model Law. In that connection, it was noted, however, that, if a right to receive the proceeds under an independent undertaking was to be covered, the relevant asset-specific recommendations of the Secured Transactions Guide should be reflected in draft Model Law. Yet another suggestion was that article 11, paragraph 2, should be deleted. In that connection, it was noted that article 11, paragraph 2, was based on recommendation 25, subparagraph (b), of the Secured Transactions Guide, which in turn was based on article 10, paragraph 1, second sentence, of the Assignment Convention dealing with personal or property rights securing an assigned receivable (although the latter was somehow different). After discussion, the Working Group decided to postpone its consideration of paragraph 3(a) until it had an opportunity to consider article 11 (see paras. 60-62 below).

17. With respect to subparagraph 3(b), it was noted that it referred to types of high-value mobile equipment covered in international conventions and those covered in domestic specialized secured transactions and registration regimes. The Working Group agreed that deference to international conventions should be addressed in a separate provision dealing with the international obligations of the enacting State (along the lines of article 3 of the UNCITRAL Model Law on Cross-Border Insolvency or, to avoid a blanket exclusion, article 38 of the Assignment Convention). As to domestic specialized regimes, it was agreed that the Guide to Enactment should explain that the enacting State could preserve any such regime by setting it out in subparagraph 3(h).

18. With respect to subparagraph 3(c), the Working Group agreed that it should be retained with the footnote stating that it might not be necessary if the enacting State

had coordinated, or otherwise addressed the hierarchy between, its secured transactions law and its intellectual property law.

19. With respect to subparagraph 3(d), it was stated that the draft Model Law should not exclude intermediated securities that were the core assets in financial markets. The Working Group noted that the matter could be referred to the Commission, with or without a recommendation by the Working Group, depending on whether the Working Group would have the time to consider it and reach consensus on it. The Working Group also noted that the matter required coordination with the International Institute for the Unification of Private Law ("Unidroit") in view of its work with respect to capital markets.

20. With respect to subparagraph 3(e), it was suggested that, to avoid inadvertently excluding even transactions relating to set off between two sellers of goods with respect to trade claims and counterclaims, the reference to "netting agreements" should be qualified by a reference to "a close-out netting agreement". The Working Group agreed that the words "a close-out netting agreement" should be included within square brackets and the definitions of the terms "financial contract" and "netting agreement", contained in the Secured Transactions Guide, should be included in article 2 of the draft Model Law within square brackets.

21. With respect to subparagraph 3(f), the Working Group agreed to postpone its consideration until it had the opportunity to consider subparagraph 3(e) and the definitions of the terms "financial contract" and "netting agreement at a future session.

22. With respect to subparagraph 3(g), the Working Group agreed that it should be revised to clarify that the draft Model Law did not apply to proceeds of assets that were outside the scope of the draft Model Law but only to the extent that other law applied and governed the matters addressed in the draft Model Law.

23. With respect to subparagraph 3(h), the Working Group agreed that it should be retained with the footnote stating that any other exceptions should be limited and set out in the draft Model Law in a clear and specific way, and with a reference in the Guide to Enactment to specialized secured transactions and registration systems (see para. 17 above).

24. With respect to paragraph 4, it was agreed that it should be deleted as it was inconsistent with recommendation 2, subparagraph (b), of the Secured Transactions Guide, it was unnecessary as it envisaged transactions involving individual secured creditors that were extremely difficult to envisage, and the relevant issues were sufficiently addressed in paragraph 5.

25. With respect to paragraph 5, the Working Group agreed that it should be broadened to cover procedural protection afforded to consumers (relating, for example, to the form of a contract or notices to be given) and consumer parties other than "an individual grantor or a debtor of an encumbered receivable".

26. With respect to paragraph 6, the Working Group agreed that it should be deleted as the meaning of the term a "small enterprise" or "micro-business" varied from State to State and attempting to provide such businesses protection similar to that afforded to consumers might inadvertently result in depriving them of the benefits of the draft Model Law and in particular of increased access to secured

credit. In that connection, it was pointed out that each State could determine whether additional rules would need to be introduced to deal with microfinancing.

27. With respect to paragraph 7, the Working Group agreed that the reference to "contractual" limitations should be deleted, as recommendation 18 of the Secured Transactions Guide, on which paragraph 7 was based, referred only to "provisions of other law". It was noted, however, that, although it was inconsistent with recommendation 18, paragraph 7 was accurate in the sense that the draft Model Law did not expressly deal with negative pledge agreements with respect to any asset other than receivables addressed in articles 23-25. The Working Group agreed to consider that matter at a later stage (see para. 68 below).

28. After discussion, the Working Group adopted the substance of article 1 subject to the above-mentioned changes (see paras. 13-27 above).

Article 2. Definitions

29. The Working Group agreed that the definitions contained in article 2 should be considered in the context of the articles in which they were used.

Article 3. Party autonomy

30. The Working Group adopted the substance of article 3 unchanged.

Article 4. General standard of conduct

31. With respect to article 4, a number of suggestions were made. One suggestion was that the word "commercially" qualifying the words "reasonable manner" in paragraph 1 should be deleted or revised as, in many jurisdictions, the concept of "commercial reasonableness" was not known and its use might inadvertently result in uncertainty and increased litigation. While some support was expressed, that suggestion was objected to. It was stated that the concept of "commercial reasonableness" referred to the commercial context and to best business practices, and was universally known and thus referred to in the Secured Transactions Guide (see recommendation 131). It was widely felt, however, that the Guide to Enactment could usefully elaborate on that concept. Another suggestion was that compliance with a provision of the draft Model Law setting out a specific standard of conduct (for example, article 90, paragraph 3) should be sufficient for the parties to be considered as having acted in commercially reasonable manner. It was agreed that that matter too could be discussed in the Guide to Enactment.

32. Yet another suggestion was that the word "general" qualifying the words "standard of conduct" in paragraph 2 should be deleted, as it suggested that the draft Model Law contained one or more specific standards of conduct. That suggestion was objected to on the ground that the standard of conduct foreseen in paragraph 2 was "general" in the sense that it applied throughout the draft Model Law, while the draft Model Law included provisions providing specific standards of conduct. Yet another suggestion was that either paragraph 2 or the first part of article 3, paragraph 1 ("except as otherwise provided in article [4, …]") should be deleted as they dealt with the same issue. That suggestion was objected to. It was stated that article 3, paragraph 1, dealt with exceptions to the principle of party autonomy, while article 4, paragraph 2, dealt with the question whether the general standard of conduct could be waived unilaterally or varied by agreement.

33. After discussion, the Working Group adopted the substance of article 4 unchanged.

B. Definitions and articles relating to security rights in non-intermediated securities (A/CN.9/WG.VI/WP.61 and Add.1-3)

34. The Working Group next proceeded to consider the definitions and articles pertaining to the treatment of non-intermediated securities in the draft Model Law.

Article 2. Definitions relating to security rights in non-intermediated securities

35. With respect to the definition of the term "securities", it was agreed that subparagraph (i) should be revised to read along the following lines: "an obligation of an issuer, or any share or similar right of participation in an issuer or the enterprise of an issuer".

36. With respect to the definition of the term "intermediated securities", it was noted that, while it appropriately tracked the definition of that term contained in the Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009; the "Geneva Securities Convention"), it might need to be aligned more closely with domestic securities law. It was also suggested that it might be necessary to also include in article 2 a definition of the term "securities account".

37. With respect to the definition of the term "non-intermediated securities", the concern was expressed that it was tautological. The concern was also expressed that it could be read to suggest that, if an intermediary directly held securities (not through another intermediary), those directly-held securities were "intermediated securities". In that connection, it was stated that, although, with respect to the intermediary, those securities should be treated as non-intermediated securities and the intermediary's rights should be determined under the laws that applied to non-intermediated securities. It was agreed that that matter could be usefully discussed in the Guide to Enactment.

38. With respect to the definition of the term "certificated non-intermediated securities", it was agreed that alternative A should be deleted and alternative B should be retained, as, while the former was concise, the latter provided more guidance to States. With respect to the bracketed words in subparagraph (ii) of alternative B, it was agreed that it should be revised to refer to the possibility of the holder of the certificate to register in the books of the issuer and thus acquire rights against the issuer, rather than as the only method for transferring the certificate. It was also agreed that the word "written" should be deleted, as a certificate should be understood as a tangible asset subject to physical possession. It was also agreed that the same change should be made to the definition of the term "uncertificated non-intermediated securities".

39. With respect to the definition of the term "control agreement", it was agreed that the Guide to Enactment should explain that the requirement for the control agreement to be "evidenced by a signed writing" should not be understood to require a single document as control agreements were often concluded with more than one document. As a matter of presentation, it was suggested that all the

definitions relating to security rights in securities should be set out together in article 2.

40. In the discussion, with respect to the definition of the term "knowledge", it was agreed that it should be recast as a rule of interpretation or deleted and the draft Model Law should refer to actual knowledge. It was also agreed that throughout the draft Model Law reference should be made to "possession", rather than to "delivery" of a tangible asset.

Article 25. Third-party effectiveness of a security right in non-intermediated securities

41. The Working Group agreed that paragraph 1 should be deleted as subparagraphs 1(a) and (b) reiterated the general methods for achieving the third-party effectiveness and subparagraph 1(c) addressed an issue of interest only to parties to the Convention providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 1930; the "Geneva Bills and Notes Convention"). In that connection, it was agreed that the provision agreed upon by the Working Group with regard to the international obligations of the enacting State was sufficient to preserve the application of the Geneva Bills and Notes Convention (see para. 17 above). In addition, it was agreed that the Guide to Enactment could discuss endorsement as a method of making a security right in non-intermediated securities effective under the Geneva Bills and Notes Convention and draw the attention of the States parties to that Convention to the need for them to coordinate their laws with the draft Model Law. In view of its decision with respect to article 25, subparagraphs 1(a) and (b), the Working Group decided that article 25, subparagraph 2(a), as well as article 23, subparagraph (a), and article 24, paragraph 1, should also be deleted for the same reasons, with a cross-reference to article 15 that reflected the general rule on third-party effectiveness of a security right. Subject to those changes, the Working Group adopted the substance of article 25.

Article 61. Priority of a security right in non-intermediated securities

42. The Working Group agreed that paragraph 1 should be deleted on the understanding that the Guide to Enactment would draw the attention of States parties to the Geneva Bills and Notes Convention to the need for them to deal with a conflict of priority between a security right made effective against all parties under the Convention and a security right made effective against third parties under the draft Model Law (see para. 41 above). It was also agreed that paragraph 5 should be placed right after paragraph 2 so that paragraphs 3-5 dealing with the priority of security rights in uncertificated securities would be set out in a more logical order. In addition, it was agreed that paragraphs 6 and 7 should be deleted as paragraph 6 and subparagraph 7(a) repeated the general rules and subparagraph 7(b) contained a substantive rule that should be left to the law relating to the transfer of securities. In that connection, the Working Group agreed that paragraphs 6 and 7 might need be reconsidered after the Working Group had an opportunity to discuss article 55 (priority of security rights in negotiable instruments). Moreover, noting that paragraph 8 appropriately preserved the application of the law relating to the transfer of securities, the Working Group agreed that it should be retained. It was also agreed that option B should also be retained for further consideration by the

Working Group. Subject to those changes, the Working Group adopted the substance of article 61.

Article 80. Rights and obligations of an issuer of non-intermediated securities

43. The Working Group agreed that reference should be made in article 80 to the law relating to the obligations of the issuer of non-intermediated securities rather than to non-intermediated securities. It was also agreed that the heading of the article (as well as the heading of section II of chapter VI and other articles in that section) should be aligned with the contents of the section and the relevant articles. Subject to those changes, the Working Group adopted the substance of article 80.

Article 99. Enforcement of a security right in non-intermediated securities

44. With respect to article 99, a number of suggestions were made. One suggestion was that the only elements of paragraph 1 that were asset specific and should thus be retained in the asset-specific rules of the enforcement chapter were the right of the secured creditor to collect funds owing under an intermediated security and the right to enforce the security right even before default with the agreement of the grantor. Another suggestion was that those elements should be reflected in a new provision that should focus on the right of a secured creditor to collect a receivable or negotiable instrument, and the funds credited to a bank account or the funds arising from a non-internediated security. Yet another suggestion was that paragraph 2 should be deleted as there was no good policy reason to require a court order if the issuer had not consented to out-of-court enforcement, as was done with respect to the right to payment of funds credited to a bank account in order to protect the depositary bank (see article 97, para. 2). There was sufficient support for all those suggestions. After discussion, the Working Group agreed that article 99 should be deleted.

45. In view of the understanding it reached in its discussion of article 99 with respect to the right of the secured creditor to enforce its security right by collecting the funds arising from certain types of assets, the Working Group decided that article 81, subparagraphs 2(e) and (f) that addressed post-default rights relating to security rights in types of asset dealt with in the asset-specific rules of the enforcement chapter should be deleted. The Working Group then proceeded to consider the structure of the remaining asset-specific rules in the enforcement chapter. It was agreed that articles 95-97 should be recast to focus on the right of the secured creditor to enforce its security right after default or before default with the agreement of the grantor by collecting a receivable, negotiable instrument, the funds credited in a bank account or the funds arising from a non-intermediated security. In addition, it was agreed that the references to the rights of third-party obligors, such as the debtor of the receivable, the issuer of a negotiable instrument, the depositary bank and the issuer of a non-intermediated security should be set out in a separate provision. Moreover, it was agreed that article 95, paragraph 3, should not apply to outright transfers of receivables. Finally, it was agreed that the secured creditor’s right to enforce its security right by collecting should not preclude any of the general post-default rights of the secured creditor (e.g. the right to enforce the security right by selling the encumbered receivable, negotiable instrument or intermediated security). Subject to those changes, the Working Group adopted the substance of articles 95 to 97.

46. With respect to article 98 (negotiable documents and tangible assets covered), the Working Group agreed that it should be deleted, as it repeated the general rule that the secured creditor had the right to enforce its security right without adding any asset-specific rule and inappropriately provided that enforcement of a security right in a negotiable document could take place before default with the agreement of the grantor.

Article 115. Law applicable to a security right in non-intermediated securities

47. With respect to article 115, a number of suggestions were made. One suggestion was that paragraph 1 should be expanded to cover issues such as government consent, form, transferability and limitations to the creation of a security right in certificated non-intermediated securities. Another suggestion was that paragraph 1 (and paragraph 4) might need to be revised to refer the effectiveness of a security right in a debt instrument (e.g. a State bond) against the issuer to the law chosen by the issuer or generally to the law governing the debt instrument. Another suggestion was that some creation and third-party effectiveness issues in paragraph 2 might need to be referred to the law of the State under which the issuer was constituted, rather than to the law of the State in which the certificate was located. Yet another suggestion was that paragraph 3 should be made subject to the law of the State under which the issuer was constituted as enforcement of the security right might involve a request to the issuer. Yet another suggestion was that enforcement might need to be referred to the law of the State in which the certificate was located or that, at least, some guidance should be provided as to the State in which enforcement might take place. After discussion, the Working Group requested the Secretariat to revise article 115 to address the suggestions made.

Article 55. Priority of a security right in negotiable instruments

48. Recalling its discussion of article 61 (see para. 42 above), the Working Group considered article 55. The concern was expressed that there might be some inconsistency between paragraph 1 (a security right made effective against third parties by possession has priority over a security right made effective against third parties by registration) and paragraph 2 (the same result, provided that certain conditions were met). In order to address that concern, a number of suggestions were made. One suggestion was that paragraph 1 should deal only with a priority conflict between security rights, while paragraph 2 should deal only with the conditions under which a buyer or other transferee would take free of a security right. That suggestion was objected to on the ground that it would result in treating secured creditors more favourably than buyers or other transferees of negotiable instruments.

49. Another suggestion was that paragraph 1 should be deleted and paragraph 2 should be the only priority rule in article 55 treating secured creditors and buyers or other transferees of negotiable instruments in the same way. Yet another suggestion, which would have the same result, was that paragraph 1 should deal with conflicts of priority between security rights. According to that suggestion, paragraph 2 should deal only with the question whether a buyer or other transferee of a negotiable instrument would acquire the negotiable instrument subject to or free of a security right that was made effective against third parties by registration. There was sufficient support for that suggestion.

50. With respect to the reference to good faith in subparagraph 2(b), while some support was expressed, it was agreed that it should be deleted, as absence of knowledge amounted essentially to good faith and the concept of good faith was used in the draft Model Law only to reflect an objective standard of conduct.

51. The Working Group next considered whether article 55 as revised should also be included in article 61. Diverging views were expressed. One view was that the matter was sufficiently important and should be addressed in the draft Model Law. Another view was that, while it was important, the matter was so complex that would require substantial work going beyond the mandate of the Working Group and thus should be left to the law of the enacting State relating to the transfer of securities. After discussion, the Working Group confirmed its earlier decision that paragraphs 6 and 7 of option A should be deleted and paragraph 8 and option B should be retained for further consideration (see para. 42 above).

C. Chapter II. Creation of a security right (A/CN.9/WG.VI/WP.61)

Article 5. Security agreement

52. With respect to article 5, it was agreed that the words “between the grantor and the secured creditor” in paragraph 1 should be retained outside square brackets, as they reflected a distinction drawn in the Secured Transactions Guide between creation (effectiveness between the parties) and effectiveness against third parties. It was also agreed that the word “they” should be retained outside square brackets and the third set of bracketed words should be deleted. It was also agreed that the bracketed text both in subparagraph 2(c) and in the definition of the term “secured obligation” should be deleted, as there was no “secured obligation” in an outright transfer of receivables. It was further agreed that the draft Model Law should instead state that the references to “secured obligation” were not applicable to outright transfers of receivables.

53. While it was noted that the reference to article 7, paragraph 2, was intended to clarify that a security right in future assets would not be created until the grantor acquired rights in the assets or the power to encumber them, it was suggested that that matter might need to be addressed either directly in article 5 or indirectly by placing article 7, paragraph 2, right after article 5. Another suggestion was that that matter might be addressed in the definition of the term “grantor”. It was agreed that the Secretariat should prepare text for the consideration of the Working Group at a future session. It was also agreed that the entire set of bracketed text in paragraph 3 should be replaced with the words “[concluded in] or [evidenced by]” with a note within square brackets that the enacting State should use the wording that would most closely suit its legal system. It was also agreed that paragraph 4 should be revised along the following lines “a security agreement may be oral if the secured creditor is in possession of the encumbered asset.”

54. Subject to the above-mentioned changes (see paras. 52 and 53 above), the Working Group adopted the substance of article 5.

Article 6. Obligations that may be secured

55. It was suggested that articles 6 and 7 should be recast to refer directly to the security right rather than to the security agreement. Referring that drafting matter to the Secretariat, the Working Group adopted the substance of article 6 unchanged.

Article 7. Assets that may be encumbered

56. The Working Group adopted the substance of article 7 unchanged (see para. 55 above).

Article 8. Proceeds

57. With respect to article 8, a number of suggestions were made. One suggestion was that the definition of the term "proceeds" in article 2 should include a reference to "revenues". That suggestion was objected to, as the notion of revenues was encompassed in the term "civil fruits" contained in that definition. Another suggestion was that paragraph 1 should deal with the description of proceeds. That suggestion was also objected to, as the rule in article 5, subparagraph (d) that dealt with the description of an encumbered asset applied both to original encumbered assets and proceeds, as the proceeds were distinct assets. Yet another suggestion was that article 8 should clarify that a security right extended to proceeds even if the encumbered asset was sold, for example, with the consent of the secured creditor, and the buyer acquired it free of the security right. That suggestion was also objected to, as the combined application of articles 8 and 42 was sufficient to bring about that result. Yet another suggestion was that paragraph 2, which tracked recommendation 20 of the Secured Transactions Guide, should be further elaborated to provide guidance to States that might not have those asset-tracing rules. Subject to that change, the Working Group adopted the substance of article 8.

Article 9. Assets commingled in a mass or product

58. With respect to paragraph 2 of article 9, the concern was expressed that limiting a security right in a mass or product to the value of the encumbered assets commingled in a mass or product before commingling might be arbitrary and expose the secured creditor to commodity price fluctuations. In order to address that concern, the suggestion was made that the limit should rather be determined on the basis of other criteria, such as weight or size, that were mentioned in the commentary of the Secured Transactions Guide (see chapter II, paras. 90-95). It was agreed that the matter should be reviewed at a future session on the basis of a note by the Secretariat. After discussion, the Working Group adopted the substance of article 9 unchanged.

Article 10. Anti-assignment clauses

59. It was agreed that article 10 should be recast to clearly indicate the parties to the agreement limiting the creation of a security right in a receivable. Subject to that change, the Working Group adopted the substance of article 10.

Article 11. Personal or property rights securing payment or other performance of encumbered receivables, negotiable instruments or any other intangible asset

60. With respect to article 11, a number of suggestions were made. One suggestion was that the word "supports" should be used to better reflect the function of a letter of credit. Another suggestion was that paragraph 2 should be clarified and its relationship with article 1, subparagraph 3(a), should be considered. Yet another suggestion was that paragraph 3 should also refer to negotiable instruments or other intangible assets. Yet another suggestion was that paragraphs 4 to 7 should be deleted and article 10 expanded to cover limitations agreed upon between the grantor and the obligor of a negotiable instrument or other intangible asset. There was sufficient support for all those suggestions.

61. The suggestion was also made that article 11 should clarify the meaning of personal and property rights securing or supporting payment or other performance of a receivable, negotiable instrument or intangible asset. It was noted, however, that that was a matter that both the Assignment Convention and the Secured Transactions Guide appropriately left to each State.

62. Subject to the above-mentioned changes (see para. 60 above), the Working Group adopted the substance of article 11.

Article 12. Rights to payment of funds credited to a bank account

63. With respect to article 12, it was agreed that there was no need to refer to article 78 (providing that the depositary bank did not need to recognize the secured creditor), as the draft Model Law should be read as a whole. It was also agreed that article 12 should be merged with article 10 as it dealt with contractual limitations to the creation of a security right. Subject to those changes, the Working Group adopted the substance of article 12.

Article 13. Negotiable documents and tangible assets covered

64. With respect to article 13, a number of suggestions were made. One suggestion was that the text in the definition of the term "possession" excluding articles 13 and 24 should be deleted, since otherwise the meaning of the term "possession" in those articles would be unclear. It was also suggested that the reference to the representative of the issuer should be deleted, as such a reference would create problems of interpretation and in any case the matter was sufficiently covered in the definition of the term "possession". In response, it was stated that recommendation 28 of the Secured Transactions Guide, on which article 13 was based, referred to possession by the issuer "directly or indirectly" to accommodate multi-modal bills of lading. Subject to those considerations, the Working Group adopted the substance of article 13.

Article 14. Tangible assets with respect to which intellectual property is used

65. With respect to article 14, a number of concerns were expressed. One concern was that it did not reflect clearly recommendation 243 of the Intellectual Property Supplement, on which it was based, namely that in the case of a tangible asset with respect to which intellectual property was used, two separate assets were involved and a security right in one did not automatically extend to the other. In order to address that concern, it was suggested that article 14 should be aligned more closely

with recommendation 243. While some doubt was expressed with respect to the use of the word "extend", there was sufficient support for that suggestion.

66. In response to a question on whether article 14 should address whether intellectual property was part of the tangible asset or not, it was noted that, in line with recommendation 243 on which it was based, article 14 appropriately left that matter to the law of the enacting State. It was also stated that, in a typical case where intellectual property was used with respect to tangible assets, a licence to use intellectual property rather than ownership in intellectual property was involved. In response to another question as to whether intellectual property could be described in a general manner, it was noted that a general description would be sufficient, unless a specific description was required under law relating to intellectual property (see Intellectual Property Supplement, para. 111).

67. Subject to the above-mentioned change (see para. 65 above), the Working Group adopted the substance of article 14.

Contractual limitations to the creation of a security right

68. Recalling its decision to delete the reference to "contractual limitations" in article 1, paragraph 7 (see para. 27 above), the Working Group proceeded to consider the treatment of such limitations in the draft Model Law. It was stated that articles 10 and 13 explicitly set aside contractual limitations to the creation of a security right in receivables and rights to receive payment of funds credited to bank accounts. In addition, it was observed that a general override of such contractual limitations was implicit in the fact that a contractual limitation was by definition binding only on the parties to the relevant contract and, under the draft Model Law, did not affect the priority of a security right created in violation of the contractual limitation. In response, it was pointed out that, while that understanding might be legitimate in some jurisdictions, in other jurisdictions, a contractual limitation might result in a party to the relevant contract not having the right to encumber an asset, with the result that a security right created in violation of that limitation would be ineffective. After discussion, it was agreed that the matter should not be addressed explicitly in the draft Model Law.

D. Chapter III. Effectiveness of a security right against third parties (A/CN.9/WG.VI/WP.61)

Article 15. General methods for achieving third-party effectiveness

69. With respect to article 15, a number of suggestions and concerns were expressed. One suggestion was that article 15 should refer to all methods for achieving third-party effectiveness, including control. That suggestion was objected to. It was widely felt that article 15 was properly cast to deal with general methods, while other methods applicable to specific types of asset were addressed in the asset-specific section of the chapter.

70. One concern was that the use of the present and past tense in the chapeau of article 15 ("the security right is effective … if it has been created") might inadvertently give the impression that third-party effectiveness could not be achieved by registration in advance of the creation of a security right. In order to

address that concern, it was suggested that present tense should be used throughout the chapeau or it should be revised to read along the following lines "a security right created … is effective against third parties if …"). While support was expressed for that suggestion, it was stated that article 30 dealt with advance registration and that the draft Model Law should be read as a whole. It was also observed that the reference to creation of a security right as a condition for it to be effective against third parties might not be necessary as, unless created, a security right would not be a "security right" under the draft Model Law.

71. Yet another concern was that there might be some disconnect between the chapeau and subparagraph (b). In order to address that concern, it was suggested that article 15 should be revised to state that a security right in an asset was effective against third parties if the secured creditor had possession of that asset. There was sufficient support for that suggestion. In a response to a concern that registration might create obstacles to non-notification factoring, the Working Group confirmed that transparency with respect to security rights was one of the key objectives of an efficient secured transactions law and thus, in line with the approach followed in the Secured Transactions Guide, registration should be listed in article 15 as a general method for achieving third-party effectiveness.

72. In the discussion, the suggestion was made that the reference to specialized registration systems should be retained in subparagraph (a) within square brackets with a footnote stating that enacting States that had such systems might wish to list them in this provision. That suggestion received sufficient support.

73. Subject to the above-mentioned suggestions (see paras. 70 and 71 above), the Working Group adopted the substance of article 15.

Article 16. Proceeds

74. With respect to article 16, a number of suggestions were made. One suggestion was that the words "without any further action by the grantor or the secured creditor" in paragraph 1 were redundant as they followed the word "automatically" and should thus be deleted. There was sufficient support for that suggestion. Another suggestion was that subparagraph 1(a) should be deleted. It was stated that, once the proceeds (e.g. inventory and receivables) were described in the notice (in line with the security agreement), they would not constitute proceeds but original encumbered assets. It was also observed that article 15 was sufficient in dealing with the third-party effectiveness of a security right in those assets. While the logic of that argument was generally recognized, the concern was expressed that deletion of subparagraph 1(a) might inadvertently give the impression that third-party effectiveness could be achieved only as provided in paragraph 2, a result that might reduce the level of transparency with regard to security rights in proceeds. It was also observed that recommendation 39 of the Secured Transactions Guide, on which article 16, paragraph 1, was based, referred to a generic, rather than a specific, description of the proceeds in the notice. Subject to the suggestions that received sufficient support, the Working Group adopted the substance of article 16.

Article 17. Changes in the method of third-party effectiveness

75. While there was general support in the Working Group for retaining article 17 outside square brackets, it was agreed that it should be reviewed once the Working

Group had an opportunity to consider chapter V (priority). With respect to the formulation of article 17, a number of suggestions were made. One suggestion was that paragraph 1 should refer to the third-party effectiveness method applicable to the relevant encumbered asset. Another suggestion was that the word "subsequently" in paragraph 1 should be retained outside square brackets. Yet another suggestion was that paragraph 2 should clarify that the time when third-party effectiveness was achieved should be the time on the basis of which priority should be determined. Subject to those suggestions, the Working Group adopted the substance of article 17.

Article 18. Lapse in third-party effectiveness

76. It was agreed that article 18 should be retained outside square brackets. As to its formulation, a number of suggestions were made. One suggestion was that it could be separated into two paragraphs. Another suggestion was that reference should be made to the third-party effectiveness method applicable to the relevant type of encumbered asset. Yet another suggestion was that article 18 might be merged with article 17. Subject to those suggestions, the Working Group adopted the substance of article 18.

Article 19. Impact of a transfer of an encumbered asset

77. Diverging views were expressed as to whether article 19 should be retained. One view was that it dealt with a priority issue that was addressed in article 42 and should thus be deleted. Another view was that it usefully dealt with the impact of a transfer of an encumbered asset on the third-party effectiveness of a security right in that asset and should thus be retained. After discussion, the Working Group agreed that article 19 should tentatively be retained until the Working Group had an opportunity to consider articles 37 and 42.

Article 20. Change of the applicable law to this Law

78. After discussion, the Working Group approved the substance of article 20 unchanged.

Article 21. Acquisition security rights in consumer goods

79. Subject to the deletion of the words "without any further action by the grantor or the secured creditor" that were redundant as they followed the word "automatically", the Working Group approved the substance of article 21.

Article 22. Personal or property rights securing payment or other performance of receivables, negotiable instruments or any other intangible asset

80. It was agreed that article 22 should be deleted as it repeated the rule contained in article 11.

Article 23. Rights to payment of funds credited to a bank account

81. Subject to any consequential changes (see paras. 41 and 69-71 above), the Working Group adopted the substance of article 23.

Article 24. Negotiable documents and tangible assets covered

82. Subject to any consequential changes (see paras. 41 above), the Working Group adopted the substance of article 24.

E. Chapter V. Priority of a security right (A/CN.9/WG.VI/WP.61/Add.1)

Article 41. Competing security rights

83. The Working Group agreed that, while the rule in paragraph 3 should be addressed in paragraph 1, paragraph 3 should be deleted and paragraph 2 should be retained outside square brackets. Subject to those changes, the Working Group adopted the substance of article 41.

Article 42. Buyers and other transferees, lessees and licensees of an encumbered asset

84. The Working Group adopted the substance of article 42 unchanged.

Article 43. Buyers and other transferees, lessees and licensees of an encumbered asset in the case of specialized registration

85. It was agreed that subparagraph 1(b) should be deleted. It was also agreed that a note should be added to state that article 43 set out an example of a rule for the consideration of the enacting State. Subject to those changes, the Working Group adopted the substance of article 43.

New rule on advance registration

86. The Working Group agreed that the draft Model Law should include a new rule stating that in the case of advance registration, priority would date back to the time of advance registration.

Article 44. Insolvency representative [and creditors in the grantor's insolvency]

87. It was agreed that article 44 should be revised to reflect more clearly the essence of recommendations 4 of the UNCITRAL Legislative Guide on Insolvency Law and 238 and 239 of the Secured Transactions Guide. Subject to those changes, the Working Group adopted the substance of article 44.

Article 45. Preferential claims

88. The Working Group adopted the substance of article 45 and agreed that the definition of the term "competing claimant" should include a reference to preferential creditors.

Article 46. Other statutory claims

89. After discussion, it was agreed that article 46 should be deleted and the claims set out therein should be discussed in the Guide to Enactment as claims that the enacting State might wish to list in article 45.

Article 47. Rights of judgement creditors

90. Subject to recasting paragraph 2, the Working Group adopted the substance of article 47.

Article 48. Non-acquisition security rights competing with acquisition security rights

91. The Working Group adopted the substance of article 48 unchanged.

Article 49. Competing acquisition security rights

92. The Working Group adopted the substance of article 49 unchanged.

Article 50. Acquisition security rights competing with the rights of judgement creditors

93. The Working Group adopted the substance of article 50 unchanged.

Article 51. Proceeds

94. The Working Group adopted the substance of article 51 unchanged.

Article 52. Subordination

95. The Working Group adopted the substance of article 52 unchanged.

Article 53. Extent of priority

96. Subject to revising paragraph 1 to state more clearly the rule that priority of a security right with respect to future advances dated back to the time the security right was made effective against third parties, the Working Group adopted the substance of article 53.

Article 54. Irrelevance of knowledge of the existence of a security right

97. It was agreed that the words “subject to … of this Law” should be deleted and reference should be made to “knowledge” on the part of the secured creditor. Subject to those changes, the Working Group adopted the substance of article 54.

Article 55. Negotiable instruments

98. Recalling its earlier discussion of article 55 (see paras. 48-51 above), the Working Group agreed that the words “acquiring its rights by agreement” contained in the chapeau of paragraph 2 should be placed within square brackets for further consideration.

Article 56. Rights to payment of funds credited to a bank account

99. It was agreed that article 56 should be recast to state the rules contained therein more clearly and in a hierarchical order. Subject to those changes, the Working Group adopted the substance of article 56.

Article 57. Money

100. Subject to clarifying the use and the meaning of the term “transfer”, the Working Group adopted the substance of article 57.

Article 58. Negotiable documents and tangible assets covered

101. The Working Group adopted the substance of article 58 unchanged.

Article 59. Certain licensees of intellectual property

102. Subject to stating the rule in a clearer manner and placing it within square brackets for further consideration, the Working Group adopted the substance of article 59.

Article 60. Acquisition security rights in intellectual property

103. It was agreed that the elements of article 60 should be incorporated into the acquisition financing provisions of the draft Model Law and article 60 should be retained within square brackets for further consideration. Subject to those changes, the Working Group adopted the substance of article 60.