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Note by the Secretariat

Addendum

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Chapter V. Priority of a security right

A. General rules

Article 28. Competing security rights

1. Subject to articles 29-40, priority among competing security rights created by the same grantor in the same encumbered asset is determined according to the order of third-party effectiveness.
2. Subject to [article 26 of the Model Registry-related Provisions] and articles 29-40, priority among competing security rights created by different grantors in the same encumbered asset is determined according to the order of third-party effectiveness.
3. The priority of a security right with respect to which a notice has been registered in the Registry before the conclusion of a security agreement or, in the case of a security right in a future asset, before the grantor acquires rights in the asset or the power to encumber it, is determined according to the time of registration.

Article 29. Competing security rights in the case of a change in the method of third-party effectiveness

The priority of a security right is not affected by a change in the method by which it is made effective against third parties, provided that there is no time period during which the security right is not effective against third parties.

Article 30. Competing security rights in proceeds

If a security right in proceeds of an encumbered asset is effective against third parties as provided in article 19, the priority of the security right in the proceeds is the same as the priority of the security right in that asset.

Article 31. Competing security rights in tangible assets commingled in a mass or product

1. If two or more security rights in the same tangible asset continue in a mass or product as provided in article 11 and each security right is effective against third parties, the priority of each security right in the mass or product is the same as its priority in that asset immediately before the asset became part of the mass or product.
2. If security rights in separate tangible assets continue in the same mass or product and each security right is effective against third parties, the secured creditors are entitled to share in the aggregate maximum value of their security rights in the mass or product according to the ratio of the value of those security rights.
3. For the purposes of paragraph 2, the maximum value of a security right is the lesser of the value determined in accordance with article 11 and the amount of the secured obligation.

Article 32. Security rights competing with rights of buyers or other transferees, lessees or licensees of an encumbered asset

1. If an encumbered asset is sold or otherwise transferred, leased or licensed while the security right in that asset is effective against third parties, the buyer or other transferee, lessee or licensee acquires its rights subject to the security right except as provided in this article.
2. A buyer or other transferee of an encumbered asset acquires its rights free of the security right, if the secured creditor authorizes the sale or other transfer of the asset free of the security right.
3. The rights of a lessee or licensee of an encumbered asset are not affected by a security right if the secured creditor authorizes the grantor to lease or license the asset unaffected by the security right.
4. A buyer of a tangible encumbered asset sold in the ordinary course of the seller's business acquires its rights free of the security right, provided that, at the time of the conclusion of the sale agreement, the buyer does not have knowledge that the sale violates the rights of the secured creditor under the security agreement.
5. The rights of a lessee of a tangible encumbered asset leased in the ordinary course of the lessor's business are not affected by the security right, provided that, at the time of the conclusion of the lease agreement, the lessee does not have knowledge that the lease violates the rights of the secured creditor under the security agreement.
6. Subject to the rights of a secured creditor with a security right in intellectual property in accordance with article 48, the rights of a non-exclusive licensee of an intangible encumbered asset licensed in the ordinary course of the licensor's business are not affected by the security right, provided that, at the time of the conclusion of the licence agreement, the licensee does not have knowledge that the licence violates the rights of the secured creditor under the security agreement.
7. If a buyer or other transferee of a tangible encumbered asset acquires its rights free of a security right, any subsequent buyer or other transferee also acquires its rights free of that security right.
8. If the rights of a lessee of a tangible encumbered asset or licensee of an intangible encumbered asset are not affected by the security right, the rights of any sub-lessee or sub-licensee are also unaffected by that security right.

Article 33. Impact of the grantor's insolvency on the priority of a security right

A security right that is effective against third parties under this Law at the time of the commencement of insolvency proceedings in respect of the grantor remains effective against third parties and retains the priority it had before the commencement of the insolvency proceedings, unless another claim has priority pursuant to [the insolvency law to be specified by the enacting State].

Article 34. Security rights competing with preferential claims

The following claims arising by operation of other law have priority over a security right that is effective against third parties but only up to [the enacting State to specify the amount for each category of claim]:

- (a) [...];
- (b) [...].¹

Article 35. Security rights competing with rights of judgement creditors

1. Subject to the rights of acquisition secured creditors in accordance with article 38, the right of a creditor that has obtained a judgement or provisional order (“judgement creditor”) has priority over a security right if, before the security right is made effective against third parties, the judgement creditor [has taken the steps to be specified by the enacting State for a judgement creditor to acquire rights in the encumbered asset or the steps referred to in the relevant provisions of other law to be specified by the enacting State].

2. If a security right is made effective against third parties before [or at the same time] the judgement creditor acquires its right in an encumbered asset by taking the steps referred to in paragraph 1, the security right has priority but that priority is limited to the greater of the credit extended by the secured creditor:

(a) Within [a short period of time to be specified by the enacting State] from or before the time when the secured creditor received a notice from the judgement creditor that the judgement creditor has taken the steps referred to in paragraph 1; or

(b) Pursuant to an irrevocable commitment of the secured creditor to extend credit in a fixed amount or an amount to be fixed pursuant to a specified formula, if the commitment was made before the secured creditor received a notice from the judgement creditor that the judgement creditor had taken the steps referred to in paragraph 1.

[Note to the Commission: The Commission may wish to note that, in the case of future assets, a security right is created and thus made effective against third parties when the grantor acquires rights in the assets or the power to encumber them (see art. 6, para. 2). Thus, the time when a security right becomes effective in future assets may coincide with the time when a judgement creditor takes the steps referred to in paragraph 1. The Commission may wish to consider whether this issue should be addressed and, if so, how and where, in the draft Model Law or in the draft Guide to Enactment (see bracketed text in art. 35, para. 2).]

¹ This provision will not need to be implemented if the enacting State does not have any preferential claims.

**Article 36. Non-acquisition security rights competing
with acquisition security rights²**

Option A³

1. An acquisition security right in assets other than inventory, consumer goods, and intellectual property or rights of a licensee under a licence of intellectual property that are held by the grantor for sale or licence in the ordinary course of the grantor's business or that are used or intended to be used by the grantor primarily for personal, family or household purposes has priority over a competing non-acquisition security right created by the grantor, provided that:

(a) The acquisition secured creditor is in possession of the assets other than inventory or consumer goods, or the agreement for the sale or licence of intellectual property has been concluded; or

(b) A notice with respect to the acquisition security right is registered in the Registry not later than the expiry of [a short period of time to be specified by the enacting State] after the grantor obtains possession of the assets other than inventory or consumer goods, or the agreement for the sale or licence of intellectual property has been concluded.

2. An acquisition security right in inventory and intellectual property or rights of a licensee under a licence of intellectual property that are held by the grantor for sale or licence in the ordinary course of the grantor's business has priority over a competing non-acquisition security right created by the grantor, provided that:

(a) The acquisition secured creditor is in possession of the inventory, or the agreement for the sale or licence of intellectual property has been concluded; or

(b) Before the grantor obtains possession of the inventory, or the agreement for the sale or licence of intellectual property has been concluded:

(i) A notice with respect to the acquisition security right is registered in the Registry; and

(ii) A notice that is sent by the acquisition secured creditor is received by the non-acquisition secured creditor that has registered a notice in the Registry with respect to a security right created by the grantor in an asset of the same kind, stating that the acquisition secured creditor has or intends to acquire an acquisition security right and describing the asset sufficiently to enable the non-acquisition secured creditor to identify the asset that is the object of the acquisition security right.

² This section includes the unitary-approach recommendations of the *Secured Transactions Guide*. If a State prefers to adopt the non-unitary approach recommendations, it may wish to consider implementing instead recommendations 187-202 of the *Secured Transactions Guide*. [In particular, States may wish to consider doing so if they have implemented regional legislation along the lines of Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions (the "Late Payment Directive"), article 9 of which, provides that "Member States shall provide in conformity with the applicable national provisions designated by private international law that the seller retains title to goods until they are fully paid for if a retention of title clause has been expressly agreed between the buyer and the seller before the delivery of the goods".]

³ A State may adopt option A or option B of this article.

3. An acquisition security right in consumer goods and intellectual property or rights of a licensee under a licence of intellectual property that are used or intended to be used by the grantor primarily for personal, family or household purposes has priority over a competing non-acquisition security right created by the grantor in the same asset [provided that the goods are below [a value to be specified by the enacting State]].

4. A notice that is sent in accordance with subparagraph 2(b)(ii) may cover acquisition security rights under multiple transactions between the same parties without the need to identify each transaction and is sufficient only for security rights in assets of which the grantor obtains possession or which the grantor acquires not later than the expiry of [a period of time to be specified by the enacting State] after the notice is received.

Option B

1. An acquisition security right in assets other than consumer goods and intellectual property or rights of a licensee under a licence of intellectual property that are used or intended to be used by the grantor primarily for personal, family or household purposes has priority as against a competing non-acquisition security right created by the grantor, provided that:

(a) The acquisition secured creditor is in possession of the assets other than consumer goods, or the agreement for the sale or licence of intellectual property has been concluded; or

(b) A notice with respect to the acquisition security right is registered in the Registry not later than the expiry of [a short period of time to be specified by the enacting State] after the grantor obtains possession of the assets other than consumer goods, or the agreement for the sale or licence of intellectual property has been concluded.

2. An acquisition security right in consumer goods and intellectual property or rights of a licensee under a licence of intellectual property that are used or intended to be used by the grantor primarily for personal, family or household purposes has priority over a competing non-acquisition security right created by the grantor in the same asset.

[Note to the Commission: The Commission may wish to note that the wording within square brackets in paragraph 3 of option A is intended to reflect the options of article 23.]

Article 37. Competing acquisition security rights

1. Subject to paragraph 2, the priority between competing acquisition security rights is determined according to article 28.

2. An acquisition security right of a seller or lessor, or a licensor of intellectual property that was made effective against third parties not later than the expiry of the period specified in article 36, subparagraph 1(b) has priority over a competing acquisition security right of a secured creditor other than a seller or lessor, or a licensor of intellectual property.

**Article 38. Acquisition security rights competing with the
rights of judgement creditors**

An acquisition security right that is made effective against third parties not later than the expiry of the period specified in article 36, subparagraph 1(b) has priority over the rights of a judgement creditor that would otherwise have priority under article 35.

Article 39. Acquisition security rights in proceeds⁴

Option A

1. In the case of an acquisition security right in assets other than inventory, consumer goods and intellectual property or rights of a licensee under a licence of intellectual property that is held by the grantor for sale or licence in the ordinary course of the grantor's business or that that is used or intended to be used by the grantor primarily for personal, family or household purposes, a security right in proceeds has the same priority as the acquisition security right.
2. In the case of an acquisition security right in inventory and intellectual property or rights of a licensee under a licence of intellectual property that is held by the grantor for sale or licence in the ordinary course of the grantor's business, a security right in proceeds has the same priority as the acquisition security right, except where the proceeds take the form of receivables, negotiable instruments, or rights to payment of funds credited to a bank account.
3. The priority of a security right in proceeds referred to in paragraph 2 is conditional on the acquisition secured creditor notifying non-acquisition secured creditors that have registered a notice in the Registry with respect to a security right created by the grantor in an asset of the same kind as the proceeds that, before the proceeds arose, the acquisition secured creditor registered a notice with respect to assets of the same kind as the proceeds in the Registry.

Option B

The priority of an acquisition security right in an asset in accordance with article 36 does not extend to its proceeds.

**Article 40. Acquisition security rights in tangible assets commingled
in a mass or product competing with non-acquisition
security rights in the mass or product**

An acquisition security right in a tangible asset that continues in a mass or product and is effective against third parties has priority over a non-acquisition security right granted by the same grantor in the mass or product.

Article 41. Subordination

1. A person may at any time subordinate the priority of its rights under this Law in favour of any existing or future competing claimant without the need for the beneficiary to be a party to the subordination.

⁴ A State may adopt option A of this article, if it adopts option A of article 36, or option B of this article, if it adopts option B of article 36.

2. Subordination does not affect the rights of competing claimants other than the person subordinating its priority and the beneficiary of the subordination.

Article 42. Future advances, future encumbered assets and maximum amount

1. Subject to the rights of judgement creditors under article 35, the priority of a security right extends to all secured obligations, including obligations incurred after the security right became effective against third parties.
2. The priority of a security right covers all encumbered assets described in a notice registered in the Registry, irrespective of whether they are acquired by the grantor or come into existence before or after the time of registration.
- [3. The priority of the security right is limited to the maximum amount set out in the notice registered in the Registry.]⁵

Article 43. Irrelevance of knowledge of the existence of a security right

Knowledge of the existence of a security right on the part of a secured creditor does not affect the priority of the security right under this Law.

B. Asset-specific rules

Article 44. Negotiable instruments

1. A security right in a negotiable instrument that is made effective against third parties by possession of the instrument has priority over a security right in the instrument that is made effective against third parties by registration of a notice in the Registry.
2. A buyer or other consensual transferee of an encumbered negotiable instrument acquires its rights free of the security right that is made effective against third parties by registration of a notice in the Registry if the buyer or other transferee:
 - (a) Qualifies as a [protected holder or other type of holder to be specified by the enacting State]; or
 - (b) [Takes possession of the negotiable instrument and gives value or takes any other act to be specified by the enacting State] without knowledge that the sale or other transfer is in violation of the rights of the secured creditor under the security agreement.

Article 45. Rights to payment of funds credited to a bank account

1. A security right in a right to payment of funds credited to a bank account that is made effective against third parties by the secured creditor becoming the account holder has priority over a competing security right that is made effective against third parties by any other method.

⁵ This provision will be necessary if the enacting State implements article 6, subparagraph 3(d), of the draft Model Law, and article 8, subparagraph (e), of the draft Model Registry-related Provisions.

2. A security right in a right to payment of funds credited to a bank account with respect to which the secured creditor is the depositary institution has priority over a competing security right made effective against third parties by any method, except a security right that is made effective against third parties by the secured creditor becoming the account holder.
3. A security right in a right to payment of funds credited to a bank account that is made effective against third parties by a control agreement has priority over a competing security right except:
 - (a) A security right of the depositary institution; or
 - (b) A security right that is made effective against third parties by the secured creditor becoming the account holder.
4. The order of priority among competing security rights in a right to payment of funds credited to a bank account that are made effective against third parties by the conclusion of control agreements is determined on the basis of the time of conclusion of the control agreements.
5. A depositary institution's right under other law to set off obligations owed to it by the grantor against the grantor's right to payment of funds credited to a bank account maintained with the depositary institution has priority as against a security right in the right to payment of funds credited to the bank account, except a security right that is made effective against third parties by the secured creditor becoming the account holder.
6. A transferee of funds from a bank account pursuant to a transfer initiated or authorized by the grantor acquires its rights free of a security right in the right to payment of funds credited to the bank account, unless the transferee has knowledge that the transfer violates the rights of the secured creditor under the security agreement.
7. Paragraph 6 does not adversely affect the rights of transferees of funds from bank accounts under [the relevant law to be specified by the enacting State].

Article 46. Money

1. A transferee that obtains possession of money that is subject to a security right acquires its rights free of the security right, unless that person has knowledge that the transfer violates the rights of the secured creditor under the security agreement.
2. This article does not adversely affect the rights of persons in possession of money under [the relevant law to be specified by the enacting State].

Article 47. Negotiable documents and tangible assets covered by negotiable documents

1. Subject to paragraph 2, a security right in a tangible asset made effective against third parties by possession of the negotiable document covering that asset has priority over a competing security right made effective against third parties by any other method.

2. Paragraph 1 does not apply to a security right in a tangible asset other than inventory if the security right of the secured creditor not in possession of the negotiable document was made effective against third parties before the earlier of:

(a) The time that the asset became covered by the negotiable document; and

(b) The time of conclusion of an agreement between the grantor and the secured creditor in possession of the negotiable document providing for the asset to be covered by a negotiable document so long as the asset became so covered within [a short period of time to be specified by the enacting State] from the date of the agreement.

3. A transferee of an encumbered negotiable document that obtains possession of the document under [the relevant law to be specified by the enacting State under which certain transferees of negotiable documents acquire their rights free of competing claims] acquires its rights free of a security right in the negotiable document and the tangible assets covered thereby that is made effective against third parties by any other method.

Article 48. Intellectual property

Article 32, paragraph 6, does not affect any rights that a secured creditor may have as an owner or licensor of intellectual property under [the relevant law relating to intellectual property to be specified by the enacting State].

Article 49. Non-intermediated securities

1. A security right in certificated non-intermediated securities made effective against third parties by the secured creditor's possession of the certificate has priority over a competing security right created by the same grantor in the same securities made effective against third parties by registration of a notice in the Registry.

2. A security right in uncertificated non-intermediated securities made effective against third parties by [[a notation of the security right] [entry of the name of the secured creditor as the holder of the securities]⁶ in the books maintained for that purpose by or on behalf of the issuer] has priority over a security right in the same securities made effective against third parties by any other method.

3. A security right in uncertificated non-intermediated securities made effective against third parties by the conclusion of a control agreement has priority over a security right in the same securities made effective against third parties by registration of a notice in the Registry.

4. The order of priority among competing security rights in uncertificated non-intermediated securities that are made effective against third parties by the conclusion of control agreements is determined on the basis of the time of conclusion of the control agreements.

5. This article does not adversely affect the rights of holders of non-intermediated securities under [the relevant law relating to the transfer of securities to be specified by the enacting State].

⁶ The enacting State may wish to insert here the method it chose in article 26.

[Note to the Commission: The Commission may wish to note that articles 44, paragraph 2, and 47, paragraph 3, while referring to other law for the terminology to be used, provide a substantive rule for transferees of encumbered negotiable instruments and negotiable documents to acquire their rights free of the security right, while article 49, paragraph 5, essentially refers the matter to other law. The Commission may thus wish to either consider following the same approach with respect to all three types of paper or, at least, reach an understanding as to how the draft Guide to Enactment should explain the different approaches followed.]
