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Draft Guide to Enactment of the draft Model Law on Secured Transactions

Note by the Secretariat

Addendum

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Chapter VIII. Conflict of laws

Introduction

1. Chapter VIII of the Model Law states the rules for determining the substantive law applicable to most of the issues dealt with in the other chapters. These rules are generally referred to as the conflict-of-laws rules. In a State that has enacted the Model Law, a court or other authority will use the conflict-of-laws rules of chapter VIII to determine the substantive law governing issues such as the creation, effectiveness against third parties, priority and enforcement of a security right, as well as the mutual rights and obligations of the grantor and the secured creditor and the relationship between third-party obligors and secured creditors. The substantive law indicated by conflict-of-laws rules may be that of the enacting State or the law of another State. It must be stressed that in the event of litigation in a State, the court or other authority will apply the conflict-of-laws rules of its own legal system to resolve the dispute (for a more elaborate discussion of the role of conflict-of-laws rules, see Secured Transactions Guide, chap. X, paras. 1-13).

2. The application of the conflict-of-laws rules relating to security rights should not be conditional on a prior determination that the case presents an international element. Whenever a conflict-of-laws rule refers to the law of a State, that reference should not be refused on the ground of the absence of true "internationality" in the situation. Otherwise, courts might disregard a conflict-of-laws rule enacted by a State by deciding that the case is not sufficiently international on the basis of discretionary criteria that are not part of the conflict-of-laws rules of that State. In other words, if in a given situation the rule of State A points to the law of State B, it must be presumed that the legislator of State A has considered that the situation of itself is presenting an international element. In the particular circumstances where additional criteria would be a prerequisite for the application of a conflict-of-laws rule of a State, these criteria should be spelled out in the conflict-of-laws rules of that State.

3. The conflict-of-laws rule dealing with the law applicable to the mutual rights and obligations of the parties is a non-mandatory law rule (it is not listed in art. 3, para. 1). This means that the parties may choose the law applicable to their contractual rights and obligations. However, the conflict-of-laws rules dealing with the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right, as well as with the relationship between third-party obligors and secured creditors (or the effect of a security right on a third-party obligor), are mandatory (see art. 3, para. 1). This means that the parties cannot be permitted by a choice-of-law clause to avoid the substantive law provisions of the legal system to which a conflict-of-laws rule refers. This must be so because security rights are property (*in rem*) rights and thus affect third parties. Allowing the parties to select the applicable conflict-of-laws rule would also defeat one of the main purposes of the conflict-of-laws rules, which is to identify the State whose substantive law will apply in the event of a priority dispute among competing claimants. For example, if there is a priority dispute between secured creditor X and secured creditor Y, it would be impossible to ascertain the law applicable to the resolution of the dispute if each of X and Y had been permitted to choose in their

security agreement with the grantor a different governing law for the ranking of their respective security right.

A. General rules

Article 81. Law applicable to the mutual rights and obligations of the grantor and the secured creditor

4. Article 81 is based on recommendation 216 of the Secured Transactions Guide (see chap. X, para. 61). It states that the parties to a security agreement are free to choose the law applicable to their contractual relationship. Article 81 follows the approach recommended by international texts on this matter, including the Hague Principles on Choice of Law in International Contracts. The question of whether there should be constraints to party autonomy with respect to the law applicable to contractual relationships is not addressed in the Model Law and is left to other conflict-of-laws rules of the enacting State. These other rules will also determine the law governing the contractual relationship of the parties in the absence of a choice of law in the security agreement; these rules will often point to the law of the State most closely connected to the security agreement. It should be noted that the rule of article 81 is confined to the contractual aspects of the security agreement. As already mentioned, matters relating to the property aspects of secured transactions (e.g. the priority of a security right) are outside the scope of freedom of contract; the parties cannot select a law other than that indicated by the conflict-of-laws rules on such matters.

Article 82. Law applicable to a security right in a tangible asset

5. Article 82 is based on recommendations 203-207 of the Secured Transactions Guide (see chap. X, paras. 28-38). It deals with the law applicable to the creation, effectiveness against third parties and priority of a security right in a tangible asset. The term "tangible asset" is defined to refer generally to all types of tangible movable asset, including money, negotiable instruments, negotiable documents and certificated non-intermediated securities (see art. 2, subpara. (ii); see also Secured Transactions Guide, chap. X, para. 26; although with regard to certificated non-intermediated securities, art. 96 prevails as an asset-specific rule).

6. Paragraph 1 states the general rule that the law applicable to these issues is the law of the location of the encumbered asset (the "*lex situs*" or the "*lex rei sitae*"). Article 88 deals with the scenario where the location of the asset changes to another State after the security right has been created. The *lex situs* rule for tangible assets is subject to five exceptions that are set out in paragraphs 2 to 4 and in options B and C of article 96.

7. The first exception provides that, if a tangible asset located in a State is covered by a negotiable document in the possession of a secured creditor in another State, the priority of the security right over the asset will be determined by the law of the location of the document, and not by the location of the asset covered by that document (see para. 2). The second exception points to the law of the grantor's location for an asset of a type which may be ordinarily used in more than one State in the course of its normal use, that is, a "mobile asset" (see para. 3; for the meaning of "location", see art. 87; for the relevant time for determining location, see art. 88).

The test is an objective one and does not refer to actual use. The most obvious example is an aircraft, which may fly from a State to many other States. The rule will apply even if a particular aircraft is actually operated only in one single State.

8. The third exception deals with a tangible asset (other than a mobile asset) in transit or to be exported (see para. 4). A security right in a tangible asset located in a State but which is in transit or destined to be moved to another State may be created and made effective against third parties under the law of its ultimate destination, if the asset reaches that destination within the period of time to be specified by the enacting State. It should be noted that: (a) if the assets do not reach the intended destination in a timely fashion, the rule in paragraph 4 will not apply; and (b) the rule in paragraph 4 does not prevent a secured creditor form taking the necessary steps to create and make the security right effective against third parties under the law of the actual location of the asset at the time such steps are taken. It should also be noted that paragraph 4 is a conflict-of-laws rule of the enacting State only and whether the security right will be treated as validly created and made effective against third parties in the State of the ultimate destination of the asset is a matter for the conflict-of-laws rules of that State.

9. The fourth exception is contained in options B and C in article 96, which refer to laws other than the location of the certificate for a security right in certificated securities.

10. Another possible exception relates to assets, with respect to which a notice of a security right may be registered in a specialized title registry or noted on a title certificate. In the case of a security right in such an asset, the law applicable to the security right is the law of the State under whose authority the registry is maintained or the certificate is located (see Secured Transactions Guide, chap. X, paras. 37 and 38, as well as rec. 205).

Article 83. Law applicable to a security right in an intangible asset

11. Article 83 is based on recommendation 208 of the Secured Transactions Guide (see chap. X, paras. 39-47). It states the general conflict-of-laws rule for the creation, effectiveness against third parties and priority of a security right in an intangible asset. The applicable law is that of the location of the grantor (for the meaning of "location", see art. 87; for the relevant time for determining location, see art. 88). It must be noted that receivables are covered by this rule, which is subject to several exceptions that are set out in articles 84 and 93-96.

12. The first exception relates to the priority of a security right in a receivable arising from a sale or lease of [or secured by] immovable property (see art. 84 below). The other exceptions relate to a security right in rights to payment of funds credited in a bank account (see art. 93), intellectual property (see art. 95, which refers both to the *lex protectionis* and to the law of the State of the grantor's location) and non-intermediated securities (see art. 96).

Article 84. Law applicable to a security right in receivables relating to immovable property

13. Article 84 is based on recommendation 209 of the Secured Transactions Guide (see chap. X, para. 54). It deals with the priority of a security right in a receivable arising from a sale or lease of [or secured by] immovable property as against the

rights of competing claimants. Introducing an exception to the general rule of article 83, article 84 refers that matter to the law of the State under whose authority the immovable property registry is organized. For article 84 to apply, the right of a competing claimant must be registrable in the relevant immovable property registry.

Article 85. Law applicable to the enforcement of a security right

14. Article 85 is based on recommendation 218 of the Secured Transactions Guide (see chap. X, paras. 64-72). Subparagraph (a) deals with the law applicable to the enforcement of a security right in a tangible asset, as defined in article 2, subparagraph (ii). It refers to the law of the State [in which enforcement takes place (*lex fori*), which in most instances would be the law of the State in which the encumbered asset would be located (for the policy reasons for this approach, see Secured Transactions Guide, chap. X, para. 66)] [in which the encumbered asset is located].

15. It should be noted that enforcement may involve several distinct acts (e.g. notice of the secured creditor's intent to obtain possession of an encumbered asset without applying to a court or other authority, disposition of an encumbered asset, and distribution of the proceeds of disposition) that may take place in different States. For example, a secured creditor may take possession of the encumbered assets in one State, dispose of them in a second State, and distribute the proceeds of disposition in a third State. As a result, the law applicable to enforcement may be the law of several States. The result would be the same if a security right is created in several tangible assets that are located in different States It should also be note that subparagraph (a) does not deal with the less frequent case where enforcement takes place in different States because the asset has been moved to another State after commencement of enforcement. In such case, it is, however, assumed that the relevant place is the place where enforcement commences.

16. Under, subparagraph (b), the law applicable to the enforcement of a security right in an intangible asset (with the exception of a right to payment of funds credited in a bank account, intellectual property and non-intermediated securities) is the law governing priority. The main advantage of this approach is that the creation, third-party effectiveness, priority and enforcement of a security right in a receivable (but not the relationship between the debtor of the receivable and the secured creditor; see art. 92) is referred to one and the same law, that is, the law of the location of the grantor (see Secured Transactions Guide, chap. X, para. 69).

Article 86. Law applicable to a security right in proceeds of an encumbered asset

17. Article 86 is based on recommendation 215 of the Secured Transactions Guide (see chap. X, paras. 55-60). The following example illustrates how the rule on the law applicable to proceeds operates. Assume that the original encumbered asset is inventory, which is subsequently sold, and the purchase price is paid into a bank account. Under paragraph 1, the law applicable to the question of whether the secured creditor automatically acquires a security right in the right to payment of the funds credited to the bank account as proceeds of the original encumbered inventory will be the law of the location of the inventory. Under paragraph 2, the law applicable to the third-party effectiveness and priority of the security right in

the proceeds will be the law applicable to the right to payment of funds credited to the bank account (see art. 93).

18. It should be noted that this type of bifurcated rule may lead to difficulties in cases where the law governing creation recognizes a broad-based automatic proceeds rule whereas the law governing third-party effectiveness and priority recognizes no or only a very limited automatic proceeds right. It should also be noted that this article is dealing only with the law applicable to proceeds derived from the original encumbered assets as a result of a disposition by the grantor or other event prior to enforcement, whereas article 88 deals with the law applicable to the distribution of proceeds derived from a disposition of the encumbered assets pursuant to post-default enforcement proceedings.

Article 87. Meaning of "location" of the grantor

19. Article 87 is based on recommendation 219 of the Secured Transactions Guide (see chap. X, paras. 73 and 74). It should be noted that the place of the central administration of a legal person is not necessarily the place of its statutory seat (or registered office). If the grantor is a legal person formed under the law of State A with its statutory seat in that State but has in State B a place of business where its senior management is based, then the grantor is located in State B. As a result of this approach, the creation, third-party effectiveness, priority and enforcement of a security right in a receivable is referred to a single law that is easy to determine and is most likely to be the law of the State in which the main insolvency proceeding with respect to the grantor will take place.

Article 88. Relevant time for determining location

20. Article 88 is based on recommendation 220 of the Secured Transactions Guide (see chap. X, paras. 75-78). It deals with the situation where the location of the asset or the location of the grantor changes from one State (State A) to another (State B) in circumstances where the applicable law is determined by reference to that location.

21. Paragraph 1 establishes that State B will recognize the existence of the security right if the latter was validly created under the law of State A at the time the asset or the grantor was located in State A. However, if a priority dispute is raised either in State A or in State B, the substantive law of State B will be applied to determine whether the security right is effective against third parties and has priority over the rights of competing claimants. As a result, for the security right to be treated as being effective against third parties either in State A or in State B, the third-party effectiveness requirements of the law of State B must have been fulfilled. This is so even if the security right had been made effective against third parties under the law of State A at the time the asset or the grantor was located in State A. Indeed, this analysis assumes that both States are enacting States.

22. Paragraph 2 constitutes an exception to the general rules of paragraph 1. In the event of a priority dispute between two security rights that have been made effective against third parties in the State of the initial location (State A, in the example), the priority dispute will be resolved under the law of the initial location.

Article 89. Exclusion of *renvoi*

23. Article 89 is based on recommendation 221 of the Secured Transactions Guide (see chap. X, para. 14). Its purpose is to reject the doctrine of *renvoi* and provide greater certainty with respect to the law applicable by avoiding the complications arising from this doctrine. Under this doctrine, the applicable law as indicated by the conflict-of-laws rules of a State (State A) includes the private international law (this term is used in the same sense as the term "conflict of laws") of the State whose law is the applicable law. As a result of this doctrine, if the conflict-of-laws rules of State A refer the priority of a security right in a receivable to the law of the location of the grantor (the law of State B) and the conflict-of-laws rules of State B refer that issue to the law governing the receivable (which is the law of State C), then a court in State A will resolve the priority dispute using the law of State C (and not the law of State B). This result, however, would create uncertainty as to the law applicable and also run contrary to the expectations of the parties. For those reasons, article 89 prohibits *renvoi* (for an exception, see art. 97, para. 3).

Article 90. Overriding mandatory rules and public policy (*ordre public*)

24. Article 90, which is based on recommendation 222 of the Secured Transactions Guide (see chap. X, para. 79) and article 11 of the Hague Principles on Choice of Law in International Commercial Contracts (the "Hague Principles"), states generally recognized principles of private international law.

25. To illustrate how the rules in paragraphs 1 and 3 will operate, assume that the law of the forum prohibits dealings in certain types of asset (such as an asset which is the proceeds of criminal activities or is the subject of international sanctions) and that the law of the State whose law is applicable does not contain such a prohibition. In such a case, the forum court may refuse to recognize as validly created a security right created in the asset under the foreign law that is applicable under the provisions of this chapter even though that law does not contain the same prohibition. However, to do so, the forum court must conclude that the application of the foreign law would be manifestly contrary to the public policy of the forum State (see para. 3).

26. Under paragraphs 2 and 4, the forum court (if it is allowed to do so under its law) may refuse to recognize as validly created a security right permitted to be created under the applicable law (even if the law applicable is the law of the forum), if the creation of such security right would be manifestly contrary to public policy in a State which has a close connection with the situation. For example, if a law firm is located in the forum State and under the applicable law of the forum State a security right may be created in receivables arising from legal services, but the location of the client is in a foreign State, which has strict confidentiality rules prohibiting a security right in a law firm's receivables arising from legal services, the forum court may refuse the application of the applicable law of the forum State, if it finds that its application would be manifestly contrary to the public policy of the State of the location of the client.

27. Paragraph 5 is intended to make clear that the rules in paragraph 1-4 may also be relied upon by an arbitral tribunal, although, unlike a court, it does not operate as part of the judicial infrastructure of a single legal system. Under paragraph 5, an arbitral tribunal may take into account the overriding mandatory provisions and

policies, for example, of the seat, however identified, or of the place where enforcement of any award would be likely to take place. Paragraph 5 requires an arbitral tribunal to determine whether it is required or entitled to take into account public policy or overriding mandatory provisions of another law, having regard (in particular) to the agreement of the parties, the designated or deemed seat of the arbitration, any institutional rules applicable to the arbitration, and the potentially controlling influence of State courts applying local arbitration legislation (see commentary to article 11(5) of the Hague Principles).

28. Under paragraph 6, the forum State may not displace the provisions of the law applicable to third-party effectiveness and priority of a security right on the ground that this would offend its public policy, and apply its own provisions or the provisions of another State. This approach is justified by the need to achieve certainty with respect to the law applicable to third-party effectiveness and priority. The same approach is followed in article 23, paragraph 2, article 30, paragraph 2, and article 31 of the Assignment Convention, as well as in article 11, paragraph 3, of the Hague Securities Convention.

Article 91. Impact of commencement of insolvency proceedings on the law applicable to a security right

29. Article 91 is based on recommendation 223 of the Secured Transactions Guide (see chap. X, paras. 80-82). Its purpose is to establish that an insolvency court in the enacting State must in principle respect the law applicable to security rights under its conflict-of-laws rules. However, nothing in article 91 restricts the application of the law of the State in which insolvency proceedings are commenced (*lex fori concursus*) to matters such as the avoidance of fraudulent or preferential transactions, the treatment of secured creditors, the ranking of claims and the distribution of proceeds in the grantor's insolvency.

B. Asset-specific rules

Article 92. Law applicable to the relationship of third-party obligors and secured creditors

30. Article 92 is based on recommendation 217 of the Secured Transactions Guide (see chap. X, paras. 62 and 63) and article 29 of the Assignment Convention. Its purpose is twofold. First, the conflict-of-laws rules on the third-party effectiveness or enforcement of a security right do not apply to the effectiveness or enforcement of a security right against the debtor of a receivable, the obligor under a negotiable instrument or the issuer of a negotiable document; they are not considered "third parties". Second, the law applicable to these issues is the law governing the legal relationship between the grantor and the debtor of the receivable, the obligor under the instrument or the issuer of the document; the same law also applies to the question of whether any of the latter may invoke that their agreement with the grantor prohibits or limits the grantor's right to create a security right in the relevant receivable, instrument or document.

Article 93. Law applicable to a security right in a right to payment of funds credited to a bank account

31. Article 93 is based on recommendation 210 of the Secured Transactions Guide (see chap. X, paras. 49-51). It departs from the general conflict-of-laws rule on the law applicable to intangible assets (see art. 83). A right to payment of funds credited to a bank account is in the generic sense a receivable of the customer against the depositary institution but a different rule applies in this case for the determination of the applicable law. Two options are offered to the enacting State for the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as to the rights and obligations between the depositary institution and the secured creditor.

32. Under option A, the applicable law is that of the State of the location of the branch or office of the depositary institution with which the account is maintained. It should be noted that a branch (or office) of a depositary institution may be considered as being located in a particular jurisdiction irrespective of whether the institution offers its services through physical offices or only through an online connection accessible electronically by customers. In this connection, it should be noted that a depositary institution must generally have a physical presence or legal address in a jurisdiction in order to be allowed by the relevant regulatory authorities to carry on business in that jurisdiction.

33. Under option B, the applicable law is the law designated in the account agreement as governing the issues that are the subject of article 93 or, in the absence of a designation of a law for these issues, the law designated by the parties to the account agreement as the law governing that agreement. To be effective for conflict-of-laws purposes, a designation must refer to the law of a State in which the depositary institution is engaged in the business of maintaining bank accounts. It must be noted, however, that the State whose law is so designated may be different than the State in which the grantor's bank account is maintained.

34. If the applicable law cannot be determined as described in the preceding paragraph, option B provides for a series of subrules along the lines of the default rules contained in article 5 of the Hague Securities Convention, which the enacting State may wish to insert in this article, if it decides to adopt option B of article 93.

Article 94. Law applicable to the third-party effectiveness of a security right in certain types of asset by registration

35. Article 94 is based on recommendation 211 of the Secured Transactions Guide (see chap. X, para. 34). This article is an exception to the conflict-of-laws rules on the third-party effectiveness of a security right in a negotiable instrument, negotiable document, right to payment of funds credited to a bank account or certificated non-intermediated security. Under articles 82, 93 and 96, the effectiveness against third parties of a security right in any of these assets is governed by the laws of a State which may be different from the State of the location of the grantor. However, under article 94, if the State of the location of the grantor recognizes registration of a notice as a method of third-party effectiveness for a security right in a negotiable instrument, right to payment of funds credited to a bank account or certificated non-intermediated security, then the law applicable to

third-party effectiveness by registration is the law of the State in which the grantor is located.

Article 95. Law applicable to a security right in intellectual property

36. Article 95 is based on recommendation 248 of the Intellectual Property Supplement (see paras. 284-337). The effect of paragraph 1 is the following. If intellectual property is protected in a particular State, the law of that State will apply to the requirements to be met for the security right in that intellectual property to be considered as having been created, made effective against third parties and enjoying priority. It should be noted that a security right in intellectual property may be granted by any person that is entitled to use the related intellectual property under the relevant intellectual property law. Therefore, the grantor may be the owner or a transferee, or a licensor or licensee of the intellectual property to be encumbered.

37. Paragraph 2 provides for an alternative way to create and make effective against certain third parties a security right in intellectual property. Under paragraph 2, the secured creditor may also use for these purposes the law of the State in which the grantor is located. The principal benefit of paragraph 2 is that if the security right has been made effective against an insolvency administrator of the grantor under the law of the grantor's location, an insolvency court in the enacting State will recognize the security right even if the third-party effectiveness requirements of all States in which the intellectual property is protected have not been fulfilled.

38. Paragraph 3 refers to the law of the grantor's location for enforcement issues relating to intellectual property. If enforcement involves several acts that take place in several States, this rule would still lead to the application of one and the same law because it is unlikely that the grantor's location would change between any of those several acts. Moreover, in the rare case where there would be such a change, it is assumed that a court would refer to the laws of the grantor's location at the time of commencement of the enforcement. It should be noted that the effectiveness of the security right against persons other than the grantor (e.g. the owner of the intellectual property, if the grantor is a licensee) is outside the scope of this article.

Article 96. Law applicable to a security right in non-intermediated securities

39. […].

[*Note to the Working Group: The Working Group may wish to note that the commentary to article 96 will be prepared after the Working Group has made a decision as to which of the options is to be retained or, alternatively, whether the article should include several options, and reached an agreement as to the contents of the article.*]

Article 97. Law applicable in the case of a multi-unit State

40. Article 97 is based on recommendations 224-227 of the Secured Transactions Guide (see chap. X, paras. 83-87). Its purpose is to deal with the law applicable where the State whose law is applicable has two or more territorial units. In such a case, paragraph 1 provides that a reference to the law of a multi-unit State is a reference to the law applicable in the relevant unit. For example, in a federal State,

secured transactions laws may fall under the legislative authority of one of its territorial units. In such case, each unit will have its own substantive law and conflict-of-laws rules. Under paragraph 2, the relevant unit is to be determined on the basis of the location of the grantor or of the encumbered asset, or otherwise under the provisions of this chapter. It should be noted that paragraphs 1 and 2 are interpretative provisions and also apply where the forum State is the State whose law is applicable under the provisions of this chapter.

41. Where the applicable law is that of a multi-unit State that is not an enacting State, paragraph 3 provides that the conflict-of-laws rules in the relevant State or territorial unit will determine whether to apply the law of a different territorial unit in the State (see Secured Transactions Guide, chap. X, para. 85). This means that the forum court is required to examine the internal conflict-of-laws rules of the State of the location of the grantor or the encumbered asset. In this regard, the Assignment Convention allows a declaration by States as to the determination of the applicable priority rule as between various territorial units (on article 37 of the Assignment Convention), but in this article there would be no declaration and the forum court would have to determine the applicable law under the conflict-of-laws rules of the multi-unit State.

42. To illustrate how the rule in paragraph 3 will operate, assume that the conflict-of-laws rules of this chapter refer to the law of the location of the grantor and that the location of the grantor under this chapter is in a territorial unit of a multi-unit State whose laws (including its conflict-of-laws rules) govern secured transactions. Also assume that the location of the grantor under this chapter is in unit A of that multi-unit State (unit A being the place of central administration of the grantor). If, however, the conflict-of-laws rules of unit A refer to the law of unit B as being the applicable law (e.g. because unit B also refers to the location of the grantor but defines the location of the grantor as its statutory seat instead of its place of central administration), then the forum court would have to apply the law of unit B if the statutory seat of the grantor is in unit B.

43. Paragraph 3 is indirectly an exception to the exclusion of the doctrine of *renvoi* (see art. 89) as it introduces “internal *renvoi*”. The purpose of the exception is to ensure that where the applicable law is that of a unit of a multi-unit State which is not an enacting State, a forum court outside that multi-unit State will apply the substantive law of the same unit as a forum court in that multi-unit State.

Chapter IX. Transition

Introduction

44. This chapter has three functions. First, it provides that prior law governing security rights (the “prior law”) is to be repealed (see art. 98). Second, it establishes the law applicable to security rights that are created while the prior law is in force but continue to be effective, perhaps for extensive periods of time, after the new secured transactions law (the “new law”) enters into force (see arts. 99-103). Third, it provides for the setting of a date on which the new law goes into effect (see art. 104). Thus, this chapter provides rules by which the law governing such

security rights moves in a fair and efficient manner from the prior law to the new one (see Secured Transactions Guide, chap. XI, paras. 1-3).

Article 98. Amendment and repeal of other laws

45. The Model Law is intended as a complete system of secured transactions law, replacing in its entirety the prior law, rather than a supplement to existing law. Accordingly, the enacting State should list in paragraph 1 and thus repeal the body of laws that comprise its secured transactions law. The way in which the repeal is effectuated will depend on the form of the prior law. Where the prior law is a free-standing code or the like, that code can be repealed in its entirety. Where the prior law is derived from statutes that also address other topics, though, the enacting State must determine how to excise the rules formerly governing security rights from the rules that apply to other topics. Where part of the prior law is based on judicial opinions (as may be the case, for example, in some common law systems), the method of repeal of the prior law must be determined by the enacting State.

46. Many other bodies of law interact with secured transactions law. In some cases, provisions of those other bodies of law may be written on the assumption that prior secured transactions law is in effect. Paragraph 2 provides the enacting State an opportunity to amend those provisions so as to mesh with the new law.

Article 99. Transitional application of this Law

47. Paragraph 1 of this article defines two terms used in this chapter. According to subparagraph 1(a), "prior law" may be the law of the enacting State or the law of another State, whose law is applicable under the conflict-of-laws rules of the enacting State. According to subparagraph 1(b), "prior security right" is a security right as long as the relevant security agreement is entered into before the entry into force of the new law, even if the security right is in future assets (see art. 2, subpara. (m)). As a result, such a security right will benefit from the transition provisions of the Model Law.

48. Paragraph 2 is based on recommendation 228 (second sentence) of the Secured Transactions Guide (see chap. XI, paras. 7-12). It provides that, by the end of the transitional period specified in article 104, the Model Law applies to all security rights within its scope, including prior security rights, except as otherwise provided in this chapter (e.g. art. 100).

49. As a result of paragraph 2, even prior security rights will be governed, at least in part, by the new law. Inasmuch as many secured transactions endure for several years, if the new law applied only to security rights from agreements entered into after the effective date of the new law, the prior law would persist for a lengthy period during which lenders, borrowers, attorneys, and judges would need to apply both laws and search for competing claimants under the rules of both. This result would entail additional cost as well as delaying the economic benefits of the new law.

Article 100. Inapplicability of this Law to actions commenced before its entry into force

50. Article 100 is based on recommendation 229 of the Secured Transactions Guide (see chap. XI, paras. 13-16). It introduces an exception to the rule in article 99

that by the end of the transitional period the Model Law applies to all security rights within its scope, including prior security rights. In certain situations, only prior law will govern an aspect of a security agreement entered into under that regime.

51. In particular, paragraph 1 provides that, if a matter with respect to a security right is the subject of litigation or arbitration proceedings commenced before the new law enters into force, the law governing the matter under dispute will remain the prior law. This paragraph applies to all disputes arising under the prior law, whether between the secured creditor and the grantor, the secured creditor and a competing claimant, or the secured creditor and a person liable, for example, on a receivable or negotiable instrument. It should be noted that the commencement of litigation before the new secured transactions law enters into force with respect to one dispute does not preclude application of the rules of the new law to a separate dispute arising under the same security agreement.

52. Paragraph 2 provides a substantive rule about enforcement of security rights created under prior law. Under the rule in this paragraph, if enforcement is commenced under prior law, the secured creditor may continue enforcement under the rules of the prior law even after the new law enters into force.

Article 101. Creation of a prior security right

53. Article 101 is based on recommendation 230 of the Secured Transactions Guide (see chap. XI, paras. 17-19). Under this article, if a security right was effectively created under prior law, this is sufficient for its continued effectiveness between the parties under the new law even if the manner of creation would not suffice under the new law. This rule avoids the invalidation of prior security rights and the creation of a situation in which the secured creditor would need to obtain cooperation from the grantor to take the additional steps necessary to continue the existence of the security right under the new law. Such cooperation may not be forthcoming from a grantor that has already received an extension of credit secured by the security right in the encumbered asset.

Article 102. Third-party effectiveness of a prior security right

54. Article 102 is based on recommendation 231 of the Secured Transactions Guide (see chap. XI, paras. 20-22). Under this article, security rights created and made effective against third parties under prior law before the effective date of the new law remain effective against third parties for a period of time under the new law, even if the conditions for third-party effectiveness under the new law have not been satisfied. The period expires at the earlier of the date specified in the Model Law or the date on which third-party effectiveness would have ceased under prior law.

55. Illustration 1: Under the former secured transactions law of State X, a security right effectively created in a receivable is automatically effective against third parties without any additional action required. Prior to the effective date of the new secured transactions law, Grantor created in favour of Creditor a security right in Grantor’s receivables. All steps necessary for creation of a security right under prior law were properly taken; therefore, under the prior law, Creditor had a security right in the receivables that was effective against third parties. Under paragraph 1, once the new secured transactions law goes into effect, Creditor’s security right will

remain effective against third parties until the expiration of the period of time specified in subparagraph 1(a).

56. Illustration 2: Under the former secured transactions law of State Y, a security right effectively created in receivables by a grantor that is a corporation was made effective against third parties by submitting a notice to the registrar of corporations. Under prior law, such a notice expired after four years. One year prior to the effective date of the new secured transactions law, Grantor created in favour of Creditor a security right in Grantor's receivables. All steps necessary for creation of a security right were properly taken, and Creditor submitted the requisite notice to the registrar of corporations the same day; as a result, under the former legal regime Creditor's security right was effective against third parties. Under paragraph 1, once the new secured transactions law goes into effect, Creditor's security right will remain effective against third parties until the earlier of: (a) the expiration of the four-year period of effectiveness under the prior law of the notice submitted to the registrar of corporations; and (b) the expiration of the period of time specified in subparagraph 1(b).

57. A secured creditor, whose security right that is effective against third-parties based on compliance with prior law will cease to be effective against third parties under the rule in paragraph 1, may take the appropriate steps under the new law to achieve third-party effectiveness. Most often, this result will be accomplished by registering a notice with the Registry. The ability to do so is aided by paragraph 2, which provides that the prior written agreement creating the security right constitutes sufficient authorization for registration of the notice.

58. Paragraph 3 provides that, so long as a security right is effective against third parties under prior law and the requirements for third-party effectiveness under the new law are satisfied before the expiration of the period specified in paragraph 1, the prior security right continues to be effective against third parties from the time when it was made effective against third parties under prior law and, thus, priority will date from that time.

59. If, however, a security right was effective against third parties under prior law but there is a gap before third-party effectiveness was achieved under the new law, paragraph 4 provides that the security right is effective against third parties only from the time it is made effective against third parties under the new law and, thus, its priority dates only from that time.

Article 103. Priority of a prior security right

60. Article 103 contains two rules relevant to determining the priority of a security right that was created under prior law. Paragraph 1 indicates how to apply the priority rule of article 28 to such a security right. Under that paragraph, the date of third-party effectiveness or registration of a notice, as applicable, under prior law is used for priority purposes if the security right was effective against third parties under prior law and remained effective against third parties under the new law under article 102, paragraph 3.

61. Under paragraph 2, however, prior law, rather than the new law, determines priority if the "priority status" of competing claimants has not changed. The purpose of this rule is to preserve priority among completing claimants that was established

under prior law when no change has occurred other than the new law becoming effective.

Article 104. Entry into force of this Law

62. Article 104 is based on recommendation 228 of the Secured Transactions Guide (see chap. XI, paras. 4-6). It leaves to the enacting State to determine the date when or the mechanism according to which the new law will enter into force. The enacting State may also wish to determine whether this article should be placed at the beginning or at the end of the new law.

63. In determining when the new law will enter into force, careful consideration should be given both to obtaining the economic benefits of the new law as soon as possible and to minimizing dislocations that may be caused by significant changes in secured transactions practice resulting from the new law. Inasmuch as the new law will have been chosen because it is an improvement over the prior law, the new law should come into force as soon as is practical. However, some lead time is necessary in order to, inter alia: (a) publicize the existence of the new law; (b) enable establishment of the Registry (or adaptation of an existing registry to the system required by the new law); and (c) enable participants in the secured transactions system, particularly present and future secured creditors, to prepare, for example, for compliance with new rules and develop new forms. For example, the new law may enter into force on a specific date or a few months after a specific date, or on the date to be specified by a decree once the Registry becomes operational.