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

Note by the Secretariat

Addendum

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VI. Article-by-article remarks

Chapter I. Scope of application and general provisions

Article 1. Scope of application

1. Article 1 is based on recommendations 1-7 of the Secured Transactions Guide (see chap. I, paras. 1-4). It is intended to set out the various types of transaction and asset covered by the Model Law (see art. 1, paras. 1-4), as well as to clarify the relationship between the Model Law and other law (see art. 1, paras. 5 and 6). Generally, the Model Law has the same comprehensive scope of application as the Secured Transactions Guide and applies to any property right in any type of movable asset, such as equipment, inventory and receivables, provided that the property right is created by an agreement and secures payment or other performance of an obligation (see art. 1, para. 1, and the definition of the term "security right" in art. 2, subpara. (kk)). However, there are a few differences between the scope of the Model Law and the scope of the Secured Transactions Guide.

2. Like the Secured Transactions Guide (see rec. 3) and the Assignment Convention (see art. 1, para. 1, and art. 2, subpara. (a)), the Model Law also applies to outright transfers of receivables by agreement (see art. 1, para. 2). The main reasons for this approach are that: (a) outright transfers of receivables often take place in the context of financing transactions; and (b) it is often difficult to determine at the outset of a transaction whether an assignment will be held to be an outright or a security assignment (see Secured Transactions Guide, chap. I, paras. 25-31). The enacting State, however, may wish to consider excluding from the scope of the Model Law certain types of outright transfers of receivables that are clearly not financing transactions (e.g. outright transfers of receivables for collection purposes only or as part of a sale of the business out of which they arose; see para. 7 below).

3. In addition, unlike the Secured Transactions Guide which covered security rights in the right to receive payment under an independent undertaking (see rec. 2 (a)), the Model Law excludes from its scope security rights in both the right to receive and the right to request payment under an independent guarantee or letter of credit, whether commercial or standby (see art. 1, para. 3 (a)). The reason is that there are various specialized financing practices in those areas and dealing with them in the Model Law would be unduly complex. States interested in addressing those practices in their general secured transactions law can always implement the relevant recommendations of the Secured Transactions Guide (recs. 27, 50, 107, 127, 176 and 212).

4. Moreover, like the Secured Transactions Guide (see rec. 4 (b)), to the extent that its provisions are inconsistent with law relating to intellectual property, the Model Law defers to law relating to intellectual property (see art. 1, para. 3 (b)). However, this limitation may not be necessary if the enacting State has already coordinated or otherwise addressed the relationship between the Model Law and its law relating to intellectual property.

5. Also, unlike the Secured Transactions Guide (see rec. 4 (c)), the Model Law does not exclude from its scope security rights in non-intermediated securities (see art. 1, para. 3 (c)). The reasons for this approach are that: (a) such securities often

are part of commercial finance transactions (in which, for example, it is common for the lender's security to include in the assets to be encumbered shares of the borrower's wholly-owned subsidiaries or the shares of the borrower itself); (b) there are wide divergences among national regimes in this regard; and (c) such securities are not addressed in any other uniform law text. To the contrary, security rights in intermediated securities are excluded as such securities are typically part of financial market transactions and are addressed in other uniform law texts (see Secured Transactions Guide, chap. 1, paras. 37 and 38).[1]

6. Finally, the Model Law excludes payment rights under or from financial contracts governed by netting agreements (see art. 1, para. 3 (d)), including foreign exchange transactions, because they raise complex issues that require special rules (see Secured Transactions Guide, chap. I, para. 39).

7. Combining the policy of recommendations 4 (a) and 7 of the Secured Transactions Guide, the Model Law permits the enacting State to exclude further types of asset (or transaction), provided that other law governs the matters that are addressed in the Model Law (see art. 1, para. 3 (e)). The reason for this approach is to avoid inadvertently creating gaps (where other law does not govern an issue addressed in the Model Law) or overlaps (where other law governs an issue addressed in the Model Law). In addition, the Model Law provides guidance to States as to possible exclusions, referring to types of asset that are subject to specialized secured transactions and asset-based registration regimes, such as ships and aircraft.

8. Similarly, with respect to the application of the Model Law to proceeds, while the relevant provision of the Model Law (see art. 1, para. 4), is formulated somewhat differently from recommendation 6 of the Secured Transactions Guide, there is no policy difference between the two rules. The policy may be explained as follows. In the case of a security right in an asset covered by the Model Law (e.g. receivables), the security right extends to its identifiable proceeds (see art. 10, para. 1); this rule applies even if the proceeds are of a type of asset that is outside the scope of the Model Law (e.g. intermediated securities), except to the extent that other law applies and governs the matters addressed in the Model Law.

9. With respect to the relationship with consumer-protection law, the Model Law is intended to preserve the application of consumer-protection law that protects a grantor or a debtor of an encumbered receivable (see art. 1, para. 5, of the Model Law, rec. 2 (b), of the Secured Transactions Guide and art. 4, para. 4, of the Assignment Convention). For example, under consumer-protection law, it may not be possible to create a security right in all present and future assets, employment benefits, at least up to a certain amount, or necessary household items of a consumer. Enacting States that do not have a developed consumer-protection law may need to consider whether enactment of the Model Law should be accompanied by the enactment of such special protections for consumers. It should also be noted that the Model Law already includes certain consumer-specific rules. For example, under article 24, an acquisition security right in consumer goods is effective against third parties upon its creation (see para. 94 below).

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[1] Such as the Unidroit Securities Convention and the Hague Securities Convention.

10. Following the approach of the Secured Transactions Guide (see rec. 18), the Model Law, is intended to preserve limitations on the creation or the enforceability of a security right in certain types of asset (e.g. employment benefits) that are based on any other statutory or case law (see art. 1, para. 6). At the same time, it is intended to ensure that such limitations based on the sole ground that an asset is a future asset, or a part of an asset or an undivided interest in an asset are overridden (see art. 8, subparas. (a) and (b)). However, paragraph 6 does not apply to contractual limitations (also known as negative pledge agreements). The Model Law overrides explicitly contractual limitations on the creation of a security right in receivables (see art. 13) or rights to payment of funds credited to a bank account (see art. 15).

11. With respect to other types of asset, contractual limitations on the creation of a security right are overridden implicitly to the extent that the Model Law allows the owner of an asset to create a security right in that asset, even if the security or other agreement expressly restricts that right. That is because the Model Law states that a grantor may encumber an asset if it has rights in the asset (art. 6, para. 1; see para. 52 below), and a person who has rights in an asset does not cease to have those rights merely because it agreed contractually not to dispose of the asset. It should be noted that the position of third-party obligors, such as the debtor of a receivable or a deposit-taking institution is protected by other provisions of the Model Law (see arts. 61-71).

12. Finally, unlike the Secured Transactions Guide, the Model Law does not apply to attachments to movable or immovable property. Thus, the Model Law does not include a provision along the lines of recommendation 5, which provides that, while the law recommended in the Secured Transactions Guide does not apply to immovable property, it does apply to attachments to immovable property. Enacting States are encouraged to consider including in their enactments of the Model Law provisions based on the relevant recommendations of the Secured Transactions Guide (see recs. 21, 25, 43, 48, 87, 88, 164, 165, 184, 195 and 196).

Article 2. Definitions and rules of interpretation

13. Article 2 contains definitions and rules of interpretation with respect to most key terms used in the Model Law. Other terms are defined or explained in various articles of the Model Law. For example, the term “judgment creditor” is defined in article 37, paragraph 1, of the Model Law.[2] Article 2 is based on the terminology and rules of interpretation of the Secured Transactions Guide (see Secured Transactions Guide, Introduction, paras. 15-20). Rules of interpretation include the following: (a) the word “or” is not intended to be exclusive; (b) the singular includes the plural and vice versa; and (c) the words “include” or “including” are not intended to indicate an exhaustive list (see Secured Transactions Guide, Introduction, para. 17).

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[2] Based on the assumption that the Model Registry Provisions may be enacted in a separate statute or other type of legal instrument, the term “registry” is defined both in article 2, subparagraph (ee) of the Model Law and article 1, subparagraph (k), of the Model Registry Provisions. If they are enacted as part of the Model Law, the latter provision will not be necessary.

Acquisition security right

14. An acquisition security right is a security right in a tangible asset that secures the grantor's obligation with respect to credit provided to enable the grantor to acquire that tangible asset (other than reified intangible assets; see art. 2, subparas. (b) and (ll)), intellectual property and the rights of a licensee in intellectual property. This definition, in conjunction with the definition of "security right", results in retention-of-title transactions, conditional sales and financial leases being treated in the Model Law as "acquisition security rights". For a security right to be an acquisition security right, the credit it secures has to be used for that purpose. Where a security right secures obligations in addition to the credit extended and used for the purpose of acquiring the encumbered asset, it is an ordinary security right to the extent of those additional obligations.

Bank account

15. To underline the distinction between a "bank account" and a "securities account", the Model Law defines: (a) the former term as "an account maintained by an authorized deposit-taking institution to which funds may be credited or debited"; (b) the latter term as "an account maintained by an intermediary to which securities may be credited or debited"; and (c) the term "securities" in a manner that clearly excludes funds (see art. 2, subparas. (c), (hh) and (ii) respectively). The term "bank account", therefore, includes any current or checking and savings account. The term does not include a right against the bank to payment evidenced by a negotiable instrument. The enacting State may wish to consider replacing the term "authorized deposit-taking institution" with the corresponding term from its own financial regulatory framework.

Certificated non-intermediated securities

16. The term "represented" used in the definition of the term "certificated non-intermediated securities" (see art. 2, subpara. (d)) is intended to be broad enough to cover the approaches taken in different jurisdictions (e.g. "covered" or "embodied"). The term "certificate" means only a tangible document subject to physical possession. Thus, securities represented by an electronic certificate are considered to be uncertificated securities under the Model Law.

Competing claimant

17. A competing claimant may have a security right in the same encumbered asset as an original encumbered asset or as proceeds (see art. 2, subpara. (e)). Other creditors of the grantor with a right in the same encumbered asset include judgment creditors.

Consumer goods

18. Unlike the definition of the term "consumer goods" in the Secured Transactions Guide on which it is based, the definition of the term in the Model Law (see art. 2, subpara. (f)) includes the word "primarily" to ensure that: (a) goods primarily used or intended to be used for personal family or household purposes and only incidentally for business purposes would be treated as consumer goods; and (b) goods primarily used or intended to be used for business purposes and only

incidentally for personal, family or household purposes would not be treated as consumer goods.

Control agreement

19. A control agreement can achieve three purposes: (a) render a security right effective against third parties (see arts. 25 and 27); (b) ensure the cooperation of the deposit-taking institution or the issuer of securities in the enforcement of a security right; and (c) establish the priority of the secured creditor that has control. Unlike the definition of this term in the Secured Transactions Guide, on which it is based, the definition of the term in the Model Law does not refer to a "signed writing" (see art. 2, subpara. (g)). This difference does not reflect a policy change but rather a decision that this matter should be left to the authorization requirements of the enacting State. In any case, a control agreement does not need to be in a single writing. It should also be noted that, on the assumption that other law would address this matter, the Model Law does not include a provision implementing the recommendations of the Secured Transactions Guide with respect to electronic communications (see Secured Transactions Guide, recs. 11 and 12).

Equipment

20. Unlike the definition of the term "equipment" in the Secured Transactions Guide on which it is based, the definition of the term in the Model Law includes the word "primarily" to ensure that: (a) goods used or intended to be used by a person primarily in the operation of its business and only incidentally for other purposes would be treated as equipment; and (b) goods used or intended to be used by a person primarily for other purposes and only incidentally in the operation of its business would not be treated as equipment (see art. 2, subpara. (l)). This definition also includes the words "other than inventory or consumer goods" as, depending on their use or intended use, the same tangible assets may be "equipment", "consumer goods" or "inventory" (see art. 2, subparas. (f), (l) and (q)).

Grantor

21. This definition makes clear that a grantor of a security right may be the debtor of the secured obligation or another person (e.g. the parent company of the debtor-subsidiary). A lessee or licensee of an asset may be regarded as a grantor if: (a) it creates a security right in whatever right it has in that asset (see subpara. (i)); or (b) the effect of the lease or licence is to transfer the encumbered asset to the lessee or licensee (see subpara. (ii)).

Insolvency representative

22. As the term "insolvency representative" is only used in the definition of the term "competing claimant" it is not defined in the Model Law. It is defined though in the Secured Transactions Guide (see Introduction, para. 20) and the UNCITRAL Legislative Guide on Insolvency Law (the "Insolvency Guide"; see Introduction, para. 12 (v)) in a sufficiently broad manner to include the person responsible for administering or supervising insolvency proceedings (see the Insolvency Guide, part two, chap. III, paras. 11-18 and 35). The Secured Transactions Guide and the Insolvency Guide contain definitions of other insolvency-related terms, such as the

term “insolvency proceedings” (which is referred to in arts. 2, subpara. (e) (iii), 35 and 94), and the term “insolvency estate”.

Intangible asset

23. The term “intangible asset” includes receivables, rights to the performance of obligations other than receivables, rights to payment of funds credited to a bank account and uncertificated non-intermediated securities, as well as any asset that is not a tangible asset (see art. 2, subpara. (p)).

Inventory

24. The term “work in process” includes “semi-processed materials”. In States in which a licence of tangible assets is possible, the term “lease of tangible assets” in this definition includes the licence of tangible assets (see art. 2, subpara. (q)).

Mass and product

25. The Model Law distinguishes between a “mass” and a “product”. A “mass” is the combination that arises when two or more tangible assets of the same type are commingled in such a way that they lose their separate identity. This could happen, for example, when a shipload of oil is pumped into a storage tanker that already contains some oil from another source, or when a truckload of one farmer’s wheat is tipped into a grain silo that already contains wheat from another farmer. In contrast, a “product” arises when one or more tangible assets are transformed into something different, through a production or manufacturing process; for example, when gold is used to make a ring, or when flour is used to make bread. The distinction is relevant to articles 11 and 33 (see paras. 67-70 below and commentary on art. 33 in A/CN.9/WG.VI/WP.71/Add.4).

Money

26. The term “money”, whose definition is based on a definition contained in the Secured Transactions Guide, is intended to include not only the national currency (i.e. banknotes and coins, as well as virtual currency, such as bitcoin) of the enacting State but also the currency of another State (see art. 2, subpara. (t)). No reference is made to currency “currently” authorized as a legal tender, because if currency is not “currently” authorized as a legal tender, it would not qualify as a legal tender. Rights to payment of funds credited to a bank account and negotiable instruments are distinct concepts in the Model Law. They are not included in the term “money”.

Movable asset

27. The enacting State may wish to ensure that this definition captures anything that its laws consider to be an asset other than immovable property (see art. 2, subpara. (u)). It may also wish to consider replacing the term “immovable property” with a term that has more meaning in the relevant jurisdiction (e.g. “land”).

Non-intermediated securities

28. The term "non-intermediated securities" refers to securities (i.e. shares and bonds) that are not held in a securities account (see art. 2, subpara. (w)). The term does not include the rights of an intermediary or a competing claimant in securities held by the intermediary directly against the issuer where equivalent securities are credited by the intermediary to a securities account in the name of the grantor. This definition is structured around the definition of the term "intermediated securities" in the Unidroit Securities Convention (see art. 1(b)). It refers only to "rights", in contrast to the language used in the Unidroit Securities Convention which refers to "rights or interests", for reasons of consistency with the terminology of the Model Law in which rights is a broad term that covers any right or interest.

Notification of a security right in a receivable

29. The definition of the term "notification of a security right in a receivable" is based on the definition of the term "notification of the assignment" in article 5, subparagraph (d) of the Assignment Convention and recommendation 118 of the Secured Transactions Guide (see art. 2, subpara. (y)). The requirement for the identification of the encumbered receivable and the secured creditor was moved to article 62, paragraph 1, as it states a substantive rule on the effectiveness of a notification of a security right, a matter that is already addressed in that article.

Possession

30. The definition of the term "possession" is based on the definition in the Secured Transactions Guide. The words "directly or indirectly" that were included in recommendation 28 of the Secured Transactions Guide were not included in this definition or article 16 (which is based on rec. 28), because the definition is sufficiently broad to cover situations in which the issuer of a negotiable document holds it through various persons responsible to perform parts of a multimodal transport contract.

Priority

31. The definition of the term "priority" is based on the definition in article 5, subparagraph (g), of the Assignment Convention (see art. 2, subpara. (aa)). The difference in its formulation from the formulation of the definition of the term in the Secured Transactions Guide is due to the need to clarify that the person with priority may be a person with a security right or another competing claimant.

Proceeds

32. The term "proceeds" in the Model Law has the same meaning as in the Secured Transactions Guide (see art. 2, subpara. (bb)). It is important to note that it covers: (a) proceeds of the sale or other disposition, lease or licence of an encumbered asset (broadly understood); (b) proceeds of proceeds; and (c) natural or civil fruits. The terms revenues, dividends and distributions, which were included in the definition of this term in the Secured Transactions Guide, have been deleted on the understanding that they are covered by the term "civil fruits".

33. The term is not limited to proceeds received by the grantor but includes proceeds received by a transferee of an encumbered asset (i.e. where A creates a

security right in its assets in favour of X and then transfers the assets to B who then creates a security right in them in favour of Y and then transfers the assets to C). The reason for this approach is that, if such a limitation were imposed, a transferee of an encumbered asset that acquired the asset subject to the security right could sell the asset further and keep the proceeds free of the security right. This result would limit the extent to which the first grantor's secured creditor would be actually secured, in particular if the value of the encumbered asset diminished or the proceeds disappeared or were difficult to trace. This does not mean that a transferee would be unprotected in any event (i.e. in the sense that C would search the registry under the name of B and would not be able to find the security right created by A). For example, a buyer or other transferee may acquire its rights free of a security right (see art. 34, para. 2) and a security right in certain types of proceeds may not be automatically effective against third parties (see. art. 19, para. 2).

34. However, it should be noted that, as a result of the approach of the Model Law, in certain circumstances, third-party transferees would have no way of finding out that the assets were proceeds of another asset in which somebody else had a security right. This would be the case at least where the proceeds would be cash proceeds and a security right in such proceeds would be effective against third parties without the registration of an amendment notice (see art. 19, para. 1, of the Model Law and art. 26, option C, of the Model Registry Provisions). Thus, the enacting State may wish to consider limiting the term "proceeds" to proceeds received by the grantor or consider other ways to avoid a prejudice to third-party financiers (e.g. requiring the registration of an amendment notice in the case of a transfer of an encumbered asset; see art. 26, option A or B, of the Model Registry Provisions or protecting good faith transferees).

35. The term "proceeds" covers situations where funds in a bank account are moved to another bank account, even at the instigation of the deposit-taking institution, and thus art. 10, para. 2, applies to such a situation, as the funds in the second bank account are "proceeds".

Receivable

36. Like the Secured Transactions Guide, the Model Law defines the term "receivable" in a broad way to cover even non-contractual receivables, such as tort receivables (see art. 2, subpara. (dd)). However, the term "receivable" does not include rights to payment evidenced by a negotiable instrument, rights to payment of funds credited to a bank account and rights to payment under a non-intermediated security, as they are treated as distinct types of asset that are subject to different asset-specific rules.

Secured obligation

37. The term "secured obligation" includes any obligation secured by a security right, including obligations arising from credit extended to finance the operation of a business or the purchase of goods (see art. 2, subpara. (gg)). It covers both monetary and non-monetary obligations; obligations already incurred at the time of the extension of the credit, as well as obligations incurred thereafter, if the security agreement so provides. As there is no secured obligation in an outright transfer of a receivable, the provisions that refer to a "secured obligation" do not apply to an outright transfer of a receivable. As in other UNCITRAL texts, in the Model Law

also the singular includes the plural and vice versa (see para. 13 above). So, for example, a reference to the secured obligation would be sufficient to cover more than one obligation, including all present and future secured obligations.

Securities

38. The definition of the term "securities" in the Model Law is narrower than the definition of the term in article 1, subparagraph (a), of the Unidroit Securities Convention (see art. 2, subpara. (hh)). The reason is that, while a broad definition is appropriate for the purposes of that Convention, it is overly broad for the purposes of the Model Law and could result in subjecting security rights in receivables, negotiable instruments, money and other generic intangible assets to the special rules applicable to security rights in non-intermediated securities. In any case, the enacting State would need to coordinate the definition of the term "securities" in its secured transactions law with the definition of the term in its securities transfer law.

Securities account

39. The definition of the term "securities account" in the Model Law is derived from article 1, subparagraph (c), of the Unidroit Securities Convention (see art. 2, subpara. (ii)).

Tangible asset

40. The term "tangible asset" in the Model Law includes consumer goods, equipment and inventory (see art. 2, subpara. (ll)). These terms do not refer to particular types of tangible asset but rather to the way in which particular tangible assets are used by the grantor (see art. 2, subparas. (f), (l) and (q)). Thus, the same cars could qualify: (a) as "consumer goods", if they are primarily used or intended to be used by the grantor for personal, family or household purposes; (b) as "equipment", if they are primarily used or intended to be used by the grantor in the operation of its business; or (c) as "inventory", if the grantor is a car dealer or manufacturer. The term also includes the reified intangible assets listed in the definition except for the purposes of certain articles that contain rules that are not appropriate for reified intangible assets. For example, the term "tangible asset' in the definition of the term "mass" (see in art. 2, subpara. (s)) does not include negotiable instruments or negotiable documents. The reason for this approach is that this does not raise an issue with respect to negotiable documents and having, for example, two separate sets of bearer bonds merged into one fungible pile is an exceptional situation that did not need to be addressed.

Writing

41. The definition of the term "writing" is intended to ensure that where the term is referred to in the Model Law (e.g. art. 6, para. 3), this reference will include electronic communication (see art. 2, subpara. (nn)). The definition is based on recommendation 11 of the Secured Transactions Guide, which in turn is based on article 9, paragraph 2, of the United Nations Convention on the Use of Electronic Communications in International Contracts.

International obligations of the enacting State

42. The Model Law leaves to the enacting State the issue whether international treaties (such as the Assignment Convention) prevail over domestic law. For example, in the case of a conflict between a provision of the Model Law and a provision of any treaty or other form of agreement to which an enacting State is a party with one or more other States, the requirements of the treaty or agreement may prevail (see art. 3 of the UNCITRAL Model Law on Cross-Border Insolvency). Such an approach may need to be limited to international treaties that directly address matters governed by the Model Law. In other States, in which international treaties are not self-executing but require internal legislation in order to become enforceable law, such an approach might be inappropriate or unnecessary (see Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency, paras. 91-93).

Article 3. Party autonomy

43. Article 3 is based on article 6 of the Assignment Convention (the first sentence of which is based on art. 6 of the United Nations Convention on Contracts for the International Sale of Goods ("CISG")) and recommendation 10 of the Secured Transactions Guide. Paragraph 1 is intended to reflect the principle that, with the exception of the provisions listed in article 3, parties are free to vary by agreement the effect of the provisions of the Model Law as between them. An agreement referred to in paragraph 1 may be not only between the secured creditor and the grantor but also between the secured creditor or the grantor and other parties whose rights may be affected by the Model Law, such as the debtor of an encumbered receivable, or between the secured creditor and a competing claimant.

44. Paragraph 2 reiterates the general principle that an agreement between two parties cannot affect the rights of a third party. The reason for stating a general principle of contract law is that the Model Law deals with relationships in which an agreement between two parties (e.g. the grantor and the secured creditor) might have or inadvertently appear to have an impact on the rights of third parties (e.g. the debtor of a receivable).

45. Paragraph 3 is intended to ensure that, if other law allows the grantor and the secured creditor to agree to resolve any dispute that may arise between them by arbitration, conciliation or negotiation, nothing in the Model Law is considered as preventing, invalidating or otherwise affecting that agreement. Depending on the efficiency of court proceedings in a particular State, these alternative dispute resolution mechanisms may provide a viable alternative to court proceedings, provided that certain issues are addressed by the relevant law, in particular with respect to arbitration, such as the arbitrability of disputes arising under a security agreement, protection of rights of third parties and the confidentiality of arbitral proceedings (see A/CN.9/WG.VI/WP.71/Add.5, para. 58).

Article 4. General standards of conduct

46. Article 4 is based on recommendation 131 of the Secured Transactions Guide (see chap. VII, para. 15). It is included in chapter I on the scope of application and general provisions, rather than in chapter VII on enforcement, as it states a standard of conduct with which parties should comply when they exercise their rights and

perform their obligations under the Model Law, even outside the context of enforcement. Under article 4, any person must exercise all its rights and perform all its obligations under the Model Law in good faith and in a commercially reasonable manner. The violation of this obligation may result in liability in damages and other consequences that are left to the relevant law of the enacting State.

47. The concept of "commercial reasonableness" refers to the commercial transaction context and best practices. Meeting the specific standards referred to in other provisions of the Model Law (e.g. art. 78, para. 4, according to which notice is to be given within a short period of time) should generally be construed as meeting the general standards of conduct referred to in this article. It should be noted that, article 4 is listed in article 3 as a mandatory law rule. As a result, the duty to act in good faith and in a commercially reasonable manner cannot be waived or varied by agreement.

Article 5. International origin and general principles

48. Article 5 is inspired by article 7 of the CISG and based on article 3 of the UNCITRAL Model Law on Electronic Commerce, article 4 of the UNCITRAL Model Law on Electronic Signatures and article 2A of the UNCITRAL Model Law on International Commercial Arbitration. It is intended to limit the extent to which a national law implementing the Model Law would be interpreted only by reference to concepts of national law.

49. The Model Law is a tool not only for modernizing but also for harmonizing secured transactions laws (see A/CN.9/WG.VI/WP.71, paras. 21-25). To promote harmonization, paragraph 1 provides that the provisions of a national law implementing the Model Law should be interpreted with reference to its international origin and the observance of good faith. The term "good faith" is also used in article 4 as an obligation of persons who have rights and obligations under the Model Law. By contrast, in this article, the term identifies a consideration to be taken into account in the interpretation of the Model Law. Paragraph 2 is intended to provide guidance with respect to the filling of gaps in a law implementing the Model Law by reference to the general principles on which the Model Law is based (see A/CN.9/WG.VI/WP.71, para. 30).

Chapter II. Creation of a security right

A. General rules

50. This chapter and several other chapters contain a section A with general rules and a section B with asset-specific rules. This approach is followed to avoid overloading the general rules with asset-specific details. It is also followed to make it easier for States that do not need some of the asset-specific rules to leave them out of its law, notwithstanding the fact that the Model Law follows the functional, integrated and comprehensive approach to secured transactions. The result of this approach is that general rules apply to all assets, but, in relation to certain types of asset, subject to the asset-specific rules. The enacting State may wish to consider whether the general and the asset-specific rules should be merged. If, however, the enacting State decides to keep those rules in separate sections of the relevant

chapters, it may wish to include in its law a provision that addresses their interrelationship along the lines explained above.

Article 6. Creation of a security right and requirements for a security agreement

51. Article 6 is based on recommendations 13-15 of the Secured Transactions Guide (see chap. II, paras. 12-37). Its purpose is to deal with the creation of a security right, as well as the form and the minimum content of a security agreement, so as to enable parties to obtain a security right in a simple and efficient manner (see Secured Transactions Guide, rec. 1, subpara. (c)). A security right is created by agreement, for the content of which there are no requirements other than those listed in paragraphs 3 and 4, and for the conclusion of which no terms of art need be used.

52. Under paragraph 1, an agreement is sufficient to create a security right, provided that at the time of the conclusion of the security agreement the grantor has either a right in the asset to be encumbered or the power to encumber it. This is the case, for example, where: (a) the grantor is the owner of the asset; and (b) the grantor is in possession of the asset on the basis of a security agreement with the owner. In addition, it should be noted that a transferor of a receivable can continue to have a right in or the power to encumber the receivable, even if it has already transferred the receivable. Moreover, it should be noted that, in the case of an anti-assignment agreement between the owner/grantor and the debtor of a receivable, the owner/grantor may not have the right as against the debtor of the receivable to transfer or encumber the receivable, but does have a right in the receivable, and also the power to encumber it. Paragraph 2 clarifies that, in the case of future assets (i.e. assets produced or acquired by the grantor after the conclusion of the security agreement; see definition in art. 2, subpara. (n)), the security right is created when the grantor acquires rights in them or the power to encumber them.

53. Paragraph 3 sets out the requirements that a written security agreement has to meet. Whether written or oral, a security agreement creates a security right but need not use any special words to achieve that result (see art. 2, subpara. (jj)). From the two alternative wordings set out in paragraph 3 within square brackets, the enacting State may wish to select the one that is most fitting to its contract law. If the enacting State retains the words “concluded in”, a security agreement that is not in written form is not effective. If the enacting State retains the words “evidenced by”, a security agreement that is not in written form may still be effective if its terms are evidenced by a writing that is signed by the grantor (e.g. in a written offer by the grantor that the secured creditor accepts by way of its conduct).

54. Depending on what it considers as most efficient financing practices and reasonable assumptions of market participants, the enacting State may wish to consider whether to retain paragraph 3 (d). One approach is to retain paragraph 3 (d) to facilitate the grantor’s access to secured financing from other creditors in situations where the value of the assets encumbered by the prior security right exceeds the maximum amount indicated in the notice registered with respect to that right. Another approach is to leave out paragraph 3 (d) to facilitate the grantor’s access to credit by the first secured creditor (for the comparative advantages and disadvantages of the two approaches, see Secured Transactions Guide, chap. IV, paras. 92-97).

55. Under paragraph 4, there is no need for a written security agreement where the secured creditor is in possession of the encumbered asset. The fact that the secured creditor is in possession of the encumbered asset is itself sufficient evidence of the existence of the security agreement.

Article 7. Obligations that may be secured

56. Article 7 is based on recommendation 16 of the Secured Transactions Guide (see chap. II, paras. 38-48). It is primarily intended to ensure that future, conditional and fluctuating obligations may be secured. The main reason for this approach is to facilitate modern financing transactions, in the context of which financing may be provided at different times depending on the needs of the grantor (e.g. revolving credit facilities for the grantor to buy inventory). This approach does not preclude the introduction of special protections for grantors (e.g. setting a maximum amount for which the security right may be enforced; see art. 6, para. 3 (d); or limiting the creation of a security right in or the transferability of specific types of movable asset, such as employment benefits in general or up to a specific amount; see art. 1, para. 6).

Article 8. Assets that may be encumbered

57. Article 8 is based on recommendation 17 of the Secured Transactions Guide (see chap. II, paras. 49-57 and 61-70). It is primarily intended to ensure that future movable assets, parts of movable assets and undivided rights in movable assets, generic categories of movable assets, as well as all movable assets of a person, may become the subject of a security right.

58. It should be noted that the fact that future movable assets may be subject to a security right does not mean that statutory limitations to the creation or enforcement of a security right in specific types of movable asset (e.g. employment benefits in general or up to a specific amount) are overridden (see art. 1, para. 6).

59. It should also be noted that the fact that all movable assets of a grantor may be subject to a security right so as to maximize the credit that may be available and improve the terms of the credit agreement does not mean that other creditors of the grantor are necessarily unprotected. The protection of other creditors (within and outside insolvency proceedings) is a matter of other law and is foreseen in articles 35 and 36 of the Model Law.

Article 9. Description of encumbered assets and secured obligations

60. Article 9 is based on recommendation 14 (d), of the Secured Transactions Guide (see chap. II, paras. 58-60). In view of their importance, the requirements for the description of encumbered assets in a security agreement are presented in a separate article. Paragraph 1 sets out the general standard that must be met in the description of encumbered assets and the secured obligations for a security agreement to be effective. Paragraph 2 is intended to ensure that a security right may be created in an asset or class of assets even if the description in the security agreement is generic, such as “all inventory” or “all receivables” (see Secured Transactions Guide, chap. II, paras. 58-60). Paragraph 3 sets out the same rule for secured obligations.

Article 10. Rights to proceeds and commingled funds

61. Article 10 is based on recommendations 19 and 20 of the Secured Transactions Guide (see chap. II, paras. 72-89). Paragraph 1 is intended to ensure that, unless otherwise agreed by the parties (as this article is not listed in article 3 as a mandatory law rule), a security right in an asset automatically extends to its identifiable proceeds. The rationale for this rule is that it reflects the normal expectations of the parties and ensures that the secured creditor is sufficiently secured. Otherwise, a grantor could effectively deprive a secured creditor of its security either by disposing of the encumbered assets to a person who would take free of the security right or to a person from whom those assets could not easily be recovered.

62. By way of example, where the original encumbered asset is inventory, the cash or receivables generated from the sale of the inventory are proceeds. If upon payment of the receivables the funds received are deposited in a bank account, the right to payment of the funds credited to the bank account are also proceeds of the inventory. So is a cheque issued by the holder of that bank account to buy new inventory and a warehouse receipt issued by the warehouse in which new inventory may be stored.

63. Paragraph 2 introduces an exception to the identifiability requirement in paragraph 1. A security right in an asset extends to its proceeds in the form of funds that are commingled with other funds even though the funds that are proceeds cannot be identified separately from the funds that are not proceeds (see para. 2 (a)). Paragraph 2 (b) limits that security right to the value of the proceeds immediately before they were commingled. So, if a sum of €1,000 is deposited in a bank account and at the time of enforcement the bank account has a balance of €2,500, the security right extends only to the sum of €1,000.

64. Paragraph 2 (c) deals with situations in which the balance in the bank account fluctuates and, at some point of time, is less than the value of the proceeds deposited (e.g. less than €1,000). In such a case, the security right extends only to the lowest value between the time when the proceeds were commingled and the time the security right in the proceeds is claimed. So, if in the example given, the balance in the account when the proceeds were deposited was €1,500, then it went down to €500 and at the time of enforcement was €750, the security right extends only to €500 (i.e. the lowest intermediate balance).

65. Where funds in a bank account are original encumbered assets, and the funds are transferred into another bank account and mixed with other funds in that other account, then the funds as transferred into that other account will be “proceeds” of the original funds, and thus the rules in article 10 will apply.

Article 11. Tangible assets commingled in a mass or transformed into a product

66. Article 11 is based on recommendations 22 and 91 of the Secured Transactions Guide (see chap. II, paras. 90-95 and 100-102, and chap. V, paras. 117-123). It accomplishes two related objectives. First, it transforms a security right in a tangible asset commingled in a mass or transformed into a product into a security right in the mass or product. Second, it limits the value of that security right by reference to the tangible asset commingled in the mass or product. Article 33 then addresses situations in which more than one secured creditor has a claim to a mass or product

as a result of a security right in its components (see commentary on article 33 in A/CN.9/WG.VI/WP.71/Add.4). Paragraph 1 is intended to ensure that a security right in a tangible asset that is commingled in a mass or transformed into product will continue in the mass or product.

67. Paragraph 2 provides that a security right in a tangible asset that extends to a mass is limited to the same proportion of the mass that the asset bore to the quantity of the entire mass immediately after it was commingled in the mass. So, if a secured creditor has a security right in €100,000 worth of oil (100,000 litres at €1 per litre) that is commingled with €50,000 worth of oil in the same tank and thus the mass has €150,000 worth of oil, the security right is limited to two-thirds of the oil in the tank. This is initially worth €100,000. If the value of the oil in the tank decreases (e.g. because the value of the oil drops or because some of the oil leaks out and cannot be recovered), however, the secured creditor will still have security in two-thirds of the oil in the tank, but the value of that two thirds will be reduced. For example, if one half of the oil leaks out so that only 75,000 litres remain, then the secured creditor will have a security right in two thirds of that 75,000 litres, i.e. over 50,000 litres only. The value of the security right will correspondingly increase, however, if the value of the oil in the tank goes up. This reflects commercial expectations, as it puts the secured creditor in the same position that the secured creditor would have been in, if the oil had not been commingled in the tank with other oil in the first place.

68. Paragraph 3 applies a slightly different rule to products, consistent with the Secured Transactions Guide (see chap. II, para. 94). If the rule in paragraph 2 were to apply to security rights in assets that are transformed into a product, then this might provide the secured creditor with a windfall gain, if the value of the finished product is greater than the value of its components (e.g. because of value that is added by the debtor's production efforts). For this reason, paragraph 3 provides instead that a security right in an asset that is transformed into a product is limited to the value of the asset immediately before it became part of the product. So, if encumbered flour worth €100 is used to make bread worth €500, the security right is limited to €100.

Article 12. Extinguishment of security rights

69. Article 12 deals with the extinguishment of security rights, which triggers the obligation of a secured creditor to return an encumbered asset or to register an amendment or cancellation notice (see art. 54 of the Model Law and art. 20, para. 3 (c), of the Model Registry Provisions). Under article 12, a security right is extinguished only where there is full payment or other satisfaction of all secured obligations and there is no longer any commitment of the secured creditor to extend further credit secured by the security right. As a result, the security right is not extinguished where temporarily there is a zero balance but there is a contingent secured exposure or an existing commitment of the secured creditor to extend further credit (e.g. on the basis of revolving credit arrangement).

B. Asset-specific rules

Article 13. Contractual limitations on the creation of security rights in receivables

70. Article 13 is based on recommendation 24 of the Secured Transactions Guide (see chap. II, paras. 106-110 and 113), which in turn is based on article 9 of the Assignment Convention. Paragraph 1 provides that an agreement limiting the grantor's right to create a security right in the receivables listed in paragraph 4 (often referred to as "trade receivables") does not prevent the creation of a security right where such an agreement exists. The rationale underlying this approach is to facilitate the use of receivables as security for credit, which is in the interest of the economy as a whole, without unduly interfering with party autonomy. This rule does not affect statutory limitations to the creation or enforcement of a security right in certain types of receivable (e.g. consumer or sovereign receivables; see art. 1, paras. 5 and 6).

71. The agreement referred to in paragraph 1 may be entered into between the initial grantor or, where the initial grantor transfers the asset to a person and that person creates a security right, that person, and the debtor of the receivable or any secured creditor who obtained a security right from the initial grantor or a subsequent grantor.

72. Paragraph 2 makes it clear that, while under paragraph 1 a security right is effective notwithstanding an agreement to the contrary, the grantor is not excused from any liability to its counter-party for damages caused by breach of that contractual provision, if such liability exists under other law. Thus, under paragraph 2, if the debtor of the receivable has sufficient negotiating power to force the creditor/grantor to accept the inclusion of an "anti-assignment clause" in their agreement and a breach of that agreement by the grantor results in a loss to the debtor of the receivable, the grantor is liable to the debtor of the receivable for damages under contract law. However, the debtor of the receivable may not avoid the contract because of that breach or raise against the secured creditor (assignee) any claim it may have against the grantor for that breach; in addition, under paragraph 3, a secured creditor that accepts a receivable as security for credit is not liable to the debtor of the receivable for the grantor's breach just because it had knowledge of the "anti-assignment clause". Otherwise, the anti-assignment agreement would in effect prevent a secured creditor from obtaining a security right in a receivable covered by the anti-assignment agreement.

73. As a result of the rules in paragraphs 1 and 2, a secured creditor does not have to examine each contract from which a receivable might arise to determine whether it contains an anti-assignment clause. This facilitates transactions relating to pools of receivables that are not specifically identified (with respect to which a search of the underlying transactions is possible but not necessarily time- or cost-efficient), as well as transactions relating to future receivables (with respect to which such a search would not be possible at the time of the conclusion of the security agreement).

74. Paragraph 3 limits the scope of the rule in paragraph 1 to what could broadly be described as trade receivables. It does not apply to so-called "financial receivables", because, where the debtor of the receivable is a financial institution,

even partial invalidation of an anti-assignment clause could affect obligations undertaken by the financial institution towards third parties (see Secured Transactions Guide, para. 108).

75. Article 13 (read together with art. 14) is intended to apply also to anti-assignment agreements limiting the creation of a security right in any personal or property rights securing or supporting payment or other performance of an encumbered intangible asset other than a receivable or an encumbered negotiable instrument.

Article 14. Personal or property rights securing or supporting payment or other performance of encumbered receivables or other intangible assets, or negotiable instruments

76. The first sentence of article 14 reflects the thrust of recommendation 25 of the Secured Transactions Guide (see chap. II, paras. 111-122). It is intended to ensure that a secured creditor with a security right in a receivable or another of the assets described therein automatically has the benefit of any personal right that supports payment or other performance of the receivable (e.g. a guarantee) and any property right that secures such payment or other performance (e.g. a security right in another asset). For example, if a receivable is secured by a guarantee or mortgage, the secured creditor with a security right in that receivable obtains the benefit of that guarantee or mortgage. This means that, if the receivable is not paid, the secured creditor may seek payment from the guarantor or enforce the mortgage (which may require that the secured creditor is registered as a mortgagee; see para. 77 below).

77. The first sentence of article 14 does not include recommendation 25 (h), of the Secured Transactions Guide (which was based on art. 10, para. 6, of the Assignment Convention). This is because it should be self-evident that the article does not apply to matters not addressed in it. Thus, to the extent that the automatic effects of the first sentence of article 14 are not impaired, any requirement under other law relating to the form or registration of the creation of a security right in any asset that is not covered in the Model Law (e.g. registration of a mortgage in the relevant immovable property registry) are not affected.

78. Under the second sentence of article 14, which reflects the thrust of article 10 of the Assignment Convention, where the rights securing or supporting payment of a receivable are independent rights under the law governing them (i.e. they are transferable only with a new act of transfer), the grantor is obliged to transfer the benefit of that right to the secured creditor (e.g. an independent guarantee or stand-by letter of credit). The reference in that sentence to the law governing the security or other supporting rights, is intended to ensure, for example, that, where an independent mortgage secures payment of an encumbered receivable, the mortgage is not automatically transferred to the secured creditor with the security right in the receivable.

79. In addition, as this matter is addressed in articles 57-68, article 14 does not affect any duties of the grantor to the debtor of the receivable or other intangible asset, or the obligor of the negotiable instrument.

Article 15. Rights to payment of funds credited to a bank account

80. Article 15 is based on recommendation 26 of the Secured Transactions Guide (see chap. II, paras. 123-125). It is intended to implement the principles underlying article 13 with respect to rights to payment of funds credited to a bank account. As a result of article 15, a security right may be created in a right to payment of funds credited to a bank account without the consent of the deposit-taking institution. However, as a result of article 69, the creation of such a security right does not affect the rights and obligations of the deposit-taking institution or obligate the deposit-taking institution to provide any information about the bank account to third parties (see commentary on art. 69 in A/CN.9/WG.VI/WP.71/Add.5).

Article 16. Negotiable documents and tangible assets covered by negotiable documents

81. Article 16 is based on recommendation 28 of the Secured Transactions Guide (see chap. II, para. 128). Its purpose is to follow existing law in which a negotiable document is treated as a reified right in the tangible assets it covers. As a result, there is no need separately to create a security right in those tangible assets if there is a security right in the document (e.g. inventory or crops deposited in a warehouse for which the warehouse operator issued a negotiable warehouse receipt).

82. In view of the definition of the term "possession" in article 2, subparagraph (z), possession by the issuer of a negotiable document includes possession by its representative or a person acting on behalf of the issuer (including in the context of multi-modal transport contracts). A security right in a negotiable document extends to the tangible assets covered by the document and will continue to exist (subject to the terms of the security agreement) even after the document no longer covers the assets. However, effectiveness against third parties through possession of the document applies only as long as the document covers the assets and lapses once they are released by the issuer (see art. 26, para. 2, and para. 99 below).

Article 17. Tangible assets with respect to which intellectual property is used

83. Article 17 is based on recommendation 243 of the Intellectual Property Supplement (see paras. 108-112). It is intended to ensure that: (a) unless otherwise agreed (as art. 17 is not listed in art. 3 among the mandatory law provisions of the Model Law), a security right in a tangible asset does not automatically extend to the intellectual property right contained therein; and (b) that a security right in an intellectual property right does not automatically extend to the tangible asset with respect to which the intellectual property right is used (e.g. the copyrighted software included in a personal computer or the trademark on an inventory of clothes).

Chapter III. Effectiveness of a security right against third parties

A. General rules

Article 18. Primary methods for achieving third-party effectiveness

84. Article 18 is based on recommendation 32 of the Secured Transactions Guide (see chap. III, paras. 19-86). It is intended to set out the primary methods for achieving third-party effectiveness (i.e. registration in the general security rights registry and possession of a tangible asset by the secured creditor). Other methods (e.g. control and registration in the books of an issuer of securities) are set out in the asset-specific provisions of this chapter (see paras. 97-101 below).

85. States that have specialized registries with respect to assets covered by the Model Law (e.g. patent or trademark registries) or title notation systems (e.g. with respect to motor vehicles) may wish to consider whether registration with respect to security rights in those types of asset should take place in the security rights registry, in the specialized registry system or both. If registration may take place in both (or, if a security right may also be noted on a title certificate), the enacting State may wish to ensure coordination (with national or international specialized registries), including by way of linking the relevant registries so that information entered in one will also become available in the other and by way of appropriate priority rules (see Secured Transactions Guide, chap. IV, para. 117, and Registry Guide, paras. 64-66). With respect to security rights in attachments to immovable property and receivables arising from sale or lease of, or secured by, immovable property, the enacting State may wish to consider issues of coordination with immovable property registries (see Registry Guide, paras. 67-69). Finally, the enacting State may wish to consider issues of international coordination among national security rights registries (Registry Guide, para. 70).

Article 19. Proceeds

86. Article 19 is based on recommendations 39 and 40 of the Secured Transactions Guide (see chap. III, paras. 87-96). It is intended to determine the circumstances in which the security right in proceeds that is provided for in article 10 is effective against third parties.

87. Under paragraph 1, a security right in proceeds in the form of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account is automatically effective against third parties, that is, without the need for any further act. For example, upon the sale of inventory that is subject to a security right that is effective against third parties, the security right in any receivable, cash, bank deposit, or negotiable instrument generated by the sale that are proceeds of the originally encumbered inventory is effective against third parties without any further act.

88. Unlike recommendation 39, on which this article is based, paragraph 1 does not refer to the description of the proceeds in the notice. This change is a drafting change and does not constitute a change of policy. The reason for this change is that, if the proceeds are described in the notice (in line with the security agreement), they

constitute original encumbered assets, and article 18 is sufficient in dealing with the third-party effectiveness of a security right in those assets.

89. For proceeds other than those covered in paragraph 1, paragraph 2 provides that, if a security right in an asset was effective against third parties, the security right in its proceeds is effective against third parties for a short period of time; thereafter, the security right in the proceeds continues to be effective against third parties only if it is made effective against third parties before the expiry of that short period by one of the methods set out in article 18 or the asset-specific provisions of this chapter. Both paragraphs 1 and 2 refer to "a security right in any proceeds arising under article 10" to ensure that they apply to "identifiable proceeds" according to article 10.

Article 20. Tangible assets commingled in a mass or transformed into a product

90. Article 20 is based on recommendation 44 of the Secured Transactions Guide. Its purpose is to ensure that a security right created in tangible assets commingled in a mass or transformed into a product under article 11 is automatically effective against third parties (for the priority of this security right, see article 42).

Article 21. Changes in the method for achieving third-party effectiveness

91. Article 21 is based on recommendation 46 of the Secured Transactions Guide (see chap. III, paras. 120 and 121). It is intended to ensure that a security right made effective by one method may later be made effective by another method, and that third-party effectiveness is continuous as long as there is no time gap between the two methods.

Article 22. Lapses in third-party effectiveness

92. Article 22 is based on recommendation 47 of the Secured Transactions Guide (see chap. III, paras. 122-127). It is intended to ensure that, if third-party effectiveness lapses, it may be re-established. In such a case, third-party effectiveness dates only from the time it is re-established.

Article 23. Continuity in third-party effectiveness upon a change of the applicable law to this Law

93. Article 23 is based on recommendation 45 of the Secured Transactions Guide (see chap. III, paras. 117-119). Under paragraph 1, if the law enacting the Model Law becomes applicable as a result, for example, of a change in the location of the encumbered asset or the grantor, a security right that was effective against third parties under the previously applicable law continues to be effective against third parties under the law enacting the Model Law for a short period of time, unless its third-party effectiveness under the initially applicable law has already lapsed. Thereafter, the security right is effective against third parties only if, before the expiry of that period, it is made effective against third parties under the relevant provisions of the law enacting the Model Law. Under paragraph 2, if the third-party effectiveness of a security right does not lapse, it dates back to the time it was first achieved under the previously applicable law.

Article 24. Acquisition security rights in consumer goods

94. Article 24 is based on recommendation 179 of the Secured Transactions Guide (see chap. IX, paras. 125-128). An acquisition security right in consumer goods is automatically effective against third parties if the price of the consumer goods is below a value to be specified by the enacting State. While this limitation is intended to exempt from registration only low-value consumer transactions, for it to be meaningful, it must be set at a reasonably high price (for the question whether a buyer acquires its rights free of an acquisition security right, see art. 34, para. 9).

95. If registration in a specialized registry or notation in a title certificate is also possible, such an acquisition security right in consumer goods should not have the special priority of an acquisition security right over a security right registered in a specialized registry. This approach would be necessary to avoid any interference with any specialized registration system (see Secured Transactions Guide, recs. 179 and 181).

B. Asset-specific rules

Article 25. Rights to payment of funds credited to a bank account

96. Article 25 is based on recommendation 49 of the Secured Transactions Guide (see chap. III, paras. 138-148). It adds to the primary methods of article 18 three asset-specific methods of achieving third-party effectiveness of a security right in a right to payment of funds credited to a bank account. First, if the secured creditor is the deposit-taking institution, no additional action is required for a security right to become effective against third parties. Second, the security right is effective against third parties upon conclusion of a control agreement (see art. 2, para. (g) (ii)) among the grantor, the secured creditor and the deposit-taking institution. Third, the security right is effective against third parties if the secured creditor becomes the account holder. The exact action required for the secured creditor to become the account holder depends on the relevant law and practice of the enacting State.

Article 26. Negotiable documents and tangible assets covered by negotiable documents

97. Article 26 is based on recommendations 51-53 of the Secured Transactions Guide (see chap. III, paras. 154-158). It addresses the relationship between the third-party effectiveness of a security right in a negotiable document and the third-party effectiveness of a security right in the tangible assets covered by the document.

98. Under paragraph 1, if a security right in a negotiable document (which extends to the assets covered by the document under article 16) is effective against third parties, the security right in the assets covered by the document is also effective against third parties for as long as the assets are covered by the document. Under paragraph 2, possession of the document is sufficient to make the security right in the assets covered by the document effective against third parties. Under paragraph 3, the security right referred to in paragraph 2 remains effective against third parties for a short period of time after the secured creditor relinquishes the

possession of the document or the assets covered by the document for the purpose of enabling the grantor to deal with the assets covered by it. In paragraph 3, the words "or the asset covered by the document", which did not appear in recommendation 53, were added to reflect actual practices and the words "physical actions like loading and unloading", which appeared in that recommendation, were deleted on the understanding that the words "dealing with the asset" are sufficiently broad to cover not only transactions like sale and exchange but also physical actions like loading and unloading.

Article 27. Uncertificated non-intermediated securities

99. Article 27 is a new provision that does not correspond to any of the recommendations of the Secured Transactions Guide, which did not apply to any type of securities (see rec. 4 (c)). It addresses the methods, other than registration of a notice, by which a security right in uncertificated non-intermediated securities may be made effective against third parties. First, the security right may be made effective against third parties by notation of the security right or entry of the name of the secured creditor as the holder of the securities in the books maintained by the issuer or another person on behalf of the issuer for that purpose (the enacting State should choose the method that best suits its legal system). Second, as in the case of a security right in a right to payment of funds credited to a bank account, the conclusion of a control agreement with respect to the encumbered securities will result in the security right in those securities being effective against third parties.

100. Under article 19 of the Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes (Geneva, 1930; the "Geneva Uniform Law"), "when an endorsement contains the statements 'value in security' ('valeur en garantie'), 'value in pledge' ('valeur en gage'), or any other statement implying a pledge, the holder may exercise all the rights arising out of the bill of exchange, but an endorsement by him has the effects only of an endorsement by an agent" (art. 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes (the "Bills and Notes Convention") contains a similar rule, according to which such a holder "may endorse the instrument only for purposes of collection").

101. An enacting State that has enacted the Geneva Uniform Law (or the Bills and Notes Convention) may wish to include: (a) this rule in its enactment of the Model Law (as a rule of creation and/or third-party effectiveness of a security right in negotiable instruments, negotiable documents and non-intermediated securities); and (b) a rule dealing with the comparative priority of such a security right. Another option would be to leave the matter to articles 46, paragraph 2, 49, paragraph 3, and 51, paragraph 5, under which such a holder of a negotiable instrument, negotiable document or non-intermediated security would take its rights free of, or unaffected by, any security right. A further option would be to leave the matter to the relevant domestic law rule dealing with the hierarchy between domestic law and an international convention (see para. 42 above).