(3) Failure to notify renders the party who has paid the lost instrument liable for any damages which the person whom he paid may suffer from such failure, provided that the total amount of the damages does not exceed the amount of the instrument and any interest and expenses which may be claimed under article 67 or 68.

(4) Delay in giving notice is excused when the delay is caused by circumstances which are beyond the control of the person who has paid the lost instrument and which he could neither avoid nor overcome. When the cause of delay ceases to operate, notice must be given with reasonable diligence.

(5) Notice is dispensed with when the cause of delay in giving notice continues to operate beyond 30 days after the last date on which it should have been given.

Article 82

(1) A party who has paid a lost instrument in accordance with the provisions of article 80 and who is subsequently required to, and does, pay the instrument, or who loses his right to recover from any party liable to him and such loss of right was due to the fact that the instrument was lost, has the right

(*a*) If security was given, to realize the security; or

(*b*) If the amount was deposited with the Court or other competent authority, to reclaim the amount so deposited.

(2) The person who has given security in accordance with the provisions of paragraph (2) (*b*) of article 80 is entitled to reclaim the security when the party for whose benefit the security was given is no longer at risk to suffer loss because of the fact that the instrument is lost.

Article 83

A person claiming payment of a lost instrument duly effects protest for dishonour by non-payment by the use of a writing that satisfies the requirements of article 80, paragraph (2) (*a*).

Article 84

A person receiving payment of a lost instrument in accordance with article 80 must deliver to the party paying the writing required under paragraph (2) (*a*) of article 80 receipted by him and any protest and a receipted account.

Article 85

(*a*) A party who paid a lost instrument in accordance with article 80 has the same rights which he would have had if he had been in possession of the instrument.

(*b*) Such party may exercise his rights only if he is in possession of the receipted writing referred to in article 84.

Article 86

(deleted)

D. Report of the Secretary-General: security interests, issues to be considered in the preparation of uniform rules (A/CN.9/186)*

CONTENTS

	Paragraphs
INTRODUCTION	1–13
Major questions	10–13
OUTLINE OF SPECIFIC ISSUES TO BE CONSIDERED	14–58
Scope of application	14–17
Exclusions from the uniform rules	18–19
Conflict of laws	20–28
Formal requisites for a valid security agreement	29–31
Description of the claim and of the secured property	32–37
Actions required to protect security interest against third parties	38–45
Priority of security interest as against interests of third parties	46–50
Proceeds	51–54
Procedures on default	55–58

INTRODUCTION

1. At its tenth session the Commission had before it three reports on security interests.[1] After considering these reports the Commission requested the Secretary-General to submit to it at its twelfth session a further report on the feasibility of uniform rules on security interests and on their possible content.[2]

2. At its twelfth session, after considering the report of the Secretary-General.[3] the Commission requested the Secretary-General to prepare a report setting out the issues to be considered in the preparation of uniform rules on

* 16 May 1980.

[1] A study on security interests, based on a study prepared by Professor Ulrich Drobnig of the Max-Planck-Institut für Ausländisches und Internationales Privatrecht (A/CN.9/131) (Yearbook ... 1977, part two, II, A); a note by the Secretariat on article 9 of the Uniform Commercial Code of the United States of America (A/CN.9/132) (Yearbook ... 1977, part two, II, B); and a report of the Secretary-General containing information on proposals for reform and on the conclusions reached by a consultative group convened jointly by the Secretariat of the Commission and the International Chamber of Commerce (A/CN.9/130).

[2] *Official Records of the General Assembly, Thirty-second Session, Supplement No. 17* (A/32/17), para. 37 (Yearbook ... 1977, part one, II, A)

[3] A/CN.9/165 (Yearbook ... 1979, part two, II, C).

security interests and to propose the manner in which those issues might be decided.[4] This report is submitted in conformity with that request.

3. The report submitted by the Secretary-General to the Commission at its twelfth session briefly discussed the possible content of uniform rules on security interests. Certain problems were isolated and various alternative methods of solving those problems were suggested.

4. The request of the Commission made at its twelfth session "to propose the manner in which [the issues to be considered in the preparation of uniform rules on security interests] might be decided" seems to call for a different approach. In order to present in a concrete form the manner in which the issues might be decided, it seems desirable to present to the Commission an outline of possible uniform rules.

5. The approach used in this report is that which found greatest favour in the Commission at its tenth session and on the basis of which the report of the Secretary-General to the twelfth session was based, namely the preparation of uniform rules, based on a functional approach, that would provide a basis for the unification of the national laws and would apply to domestic as well as to international transactions.

6. The underlying conceptual basis for the functional approach is that the rules should be determined by the nature of the credit transaction and the economic and social policies which are deemed to be desirable. There is specifically rejected the idea that the rights of the parties should be influenced by any consideration as to whether the debtor or the creditor may happen to be the "owner" of the secured property[5] or by the use of other legal concepts which were not originally developed in the context of the law of security interests.

7. The use of a functional approach has been found to have the advantage that it is possible to make all forms of consensual security interests the subject of one statute. By so doing it is possible to harmonize the law in respect of all credit transactions which have the same economic function. For example the same rights might be given to (1) the unpaid seller of goods who has "reserved the title" to the goods until payment, (2) a financing institution to which the unpaid seller has transferred his claim and "reservation of title", and (3) a financing institution which has paid the seller directly, or has lent the money to the buyer to pay the seller, and has taken a security interest in the goods purchased. In all three cases the seller or the financing institution have given credit to the buyer to permit the buyer to purchase the goods.

8. The use of the functional approach to security interests also makes it easier to develop clear and coherent rules to govern those cases in which the property of the debtor is the subject of several different security interests in the course of the same credit transaction. For example, when the importation of goods has been financed under a documentary letter of credit, the financing bank has a security interest in the goods through its possession of the bills of lading. If the buyer must sell the goods in order to repay the bank, the bank may agree to hand over the documents to the buyer so that he can take possession of the goods from the carrier and place them in a warehouse prior to resale. In some, but not all, common law countries a short-term non-possessory security interest under the designation of "trust-receipt" is available to cover the period of time until the goods have been placed in the warehouse. Once the goods are in the warehouse the bank may be able to assert a security interest in the goods through possession of the warehouse receipt, if the law of the State in question grants to warehouse receipts the characteristics of a document of title such as is granted to bills of lading. Alternatively, the bank may assert a non-possessory security interest, if that is allowed by the applicable law. Therefore, if the bank is to have a continuous security interest in the goods throughout this transaction, the law must permit of the mutation of the security interest from possessory to non-possessory and, perhaps, back to possessory. This can easily be done in a statute using the functional approach to security interests.

9. Similarly by treating all forms of security interest in one statute, it is easier to regulate conflicts in priority between different security interests in the same secured property which arise through different financing transactions. One such example is the conflict between the financer of book debts, sometimes called a factor, and the unpaid seller of goods who reserved title to the goods and claims an interest in the book debts which arose as a result of the resale of the goods.[6] In a case such as this it is technically difficult to devise a satisfactory solution to the conflict in priorities so long as the rights of the financer of the book debts and the unpaid seller of the goods are governed by different statutes.

Major questions

10. There are six major questions to be dealt with in a law on security interests:

In what kinds of moveables can a security interest be created under the law?

What formalities, if any, must the debtor and secured creditor fulfil in order to create a valid security interest?

To what extent are the debtor and the secured creditor free to determine by agreement the terms which would govern their relationship and to what extent are the terms determined by the law?

What are the rights which the secured creditor can have against third parties claiming an interest in the secured property (purchasers from the debtor, other creditors of

[4] *Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17* (A/34/17), para. 54 (Yearbook ... 1979, part one, II, A).

[5] Throughout this report the property which is the security for the credit transaction will be referred to as the "secured property".

[6] As noted in UNIDROIT Study LVIII-Doc. 7, p. 7 (Report of the Secretariat of UNIDROIT on the first session of the Study Group for the preparation of uniform rules on the contracts of factoring held in Rome on 5 and 6 February 1979), "It is a well known fact that the problem of the conflicts which may arise between the factor and the supplier's creditors when the latter has assigned the debts in question several times over has met with different solutions in the various national legal systems".

the debtor, the mass of creditors in the bankruptcy of the debtor)?

What must the secured creditor do to have these rights?

What are the procedures to be followed in case of default by the debtor?

11. This report suggests the following responses to these six questions:

All items which are classified as moveables under the law of the State in question could have a security interest created in them. However, special rules may be necessary where particular kinds of moveables present particular problems.

To create a valid security interest the secured creditor must either take possession of the secured property or there must be a written agreement or written confirmation of an oral agreement.

The security agreement may, in principle, contain any terms governing the relationship between the debtor and the secured creditor which the parties find relevant. Certain limitations on the principle of freedom of contract as it affects the relationship between the debtor and the secured creditor might be in the uniform rules themselves. Other limitations, if any, might be left to the general law on abusive contractual provisions or to the specific provisions of consumer protection law, if security interests arising out of consumer credit transactions are to be included within the uniform rules.

By doing the appropriate acts, the secured creditor should be able to acquire priority over the rights of all third parties, except certain buyers or lessees of inventory, instruments or negotiable documents. Before the secured creditor has done those acts, his security interest should be subject to the rights of most third parties who claim an interest in the secured property.

The actions to be taken by the secured creditor in order to be generally protected against the competing claims of third parties may differ depending on the nature of the secured property or on the nature of the transaction. It may also be desirable not to attempt to unify the rules in this respect but to offer certain alternatives. The problems arising in international trade could then be settled through clear rules on conflict of laws.

If the debtor is in default, the secured creditor should normally be allowed to take possession of the secured property and have it sold. If the secured property consists of commercial goods or other items of which the value can easily be determined, it should be allowed to be sold or otherwise disposed of by the secured creditor through normal commercial channels. In other cases, the disposition should be by the appropriate official of the State or person authorized by the State to conduct such sales.

12. A text embodying the functional approach to the law of security interests has been adopted or officially recommended for adoption in both civil law[7] and common law legal systems.[8] There seems to be nothing in the basic concepts or in the techniques by which those concepts are implemented which would inhibit the adoption of a statute using the functional approach in any legal system in which it was desired to facilitate the use of secured credit.

13. Nevertheless, experience has shown that absolute identity of text in different States probably cannot be achieved because of the need for the law of security interests to be integrated with other aspects of the law. It is not thought that this need be a serious obstacle to the work of the Commission. The preparation of a model law with an indication of alternative provisions would serve to harmonize the law both within and amongst those legal systems which adopted a statute based upon the model law.

OUTLINE OF SPECIFIC ISSUES TO BE CONSIDERED

Scope of application

14. The provisions governing the scope of application of a law on security interests must state the types of security interests which are to be included and the kinds of moveables in which those security interests can be created.

15. It is desirable that, to the extent possible, the model law should govern all forms of security interest in all kinds of moveables.

16. In regard to most issues which arise in the law of security interests, the policies which should dictate the appropriate rule would be the same no matter what the form of the secured property. To the extent that the form of the secured property calls for a special rule in respect of one issue or another, such a rule could easily be accommodated within the uniform rules. Similarly, there are only a few differences in policy or mechanics which arise between a security interest to assure payment of the purchase price and a security interest to assure repayment of a loan.

17. The consolidation in one law of all forms of security interests in all forms of moveables makes it possible to reconcile the interests of the various claimants in an organized manner. This is not possible where the various claimants to the assets of a debtor rely upon different laws enacted at different times to meet different situations.

Exclusions from the uniform rules

18. A broad statement of scope of application as is proposed may bring within its scope certain marginal transactions which it may be thought best to exclude from the operation of the model law. By way of example, it may be thought desirable specifically to exclude from the operation of the model law:

A lien, charge or other interest given by statute or other rule of law for services or materials;

An assignment of present or future compensation for labour or personal services;

An assignment of book debts made solely to facilitate their collection for the assignor.

[7] Québec, Report on the Québec Civil Code, Civil Code Revision Office (1977), vol. I, Book Four, Title Five, "Security on Property".

[8] United States of America, Uniform Commercial Code, Article 9. Ontario, Personal Property Security Act, Stat. Ont. 1967, c. 73, as amended. For the common law provinces of Canada in general, Model Uniform Personal Property Security Act. India, Report of Banking Laws Committee on Personal Property Security Act 1977.

19. This list is illustrative only, and certainly far from exhaustive. It is likely that, even if the model law were to contain a list of excluded transactions, each State which wished to enact the model law would have to consider which transactions under its law should be specifically excluded from the application of these rules.

Conflict of laws

20. In the context of international trade, the subject of conflict of laws raises some of the most important and difficult questions in respect of security interests.

21. At the tenth session of the Commission it was already noted that it would be difficult to construct rules in respect of conflict of laws so long as the basic substantive rules differed by too great an extent in the various legal systems.[9] However, a model law in respect of security interests which would have the effect of unifying or harmonizing the substantive law might well include rules governing conflict of laws.

22. There are three principal problems which generate questions of conflict of laws: (1) which law governs the validity of the security agreement between the debtor and the secured creditor, (2) which law governs the actions to be taken by the secured creditor in order to be protected against third parties (e.g. other creditors of the debtor, good faith purchasers of the secured property), and (3) which law governs the extent of protection to be given the secured creditor against those third parties.

23. The answers to these three questions need not necessarily be the same for all types of secured property. It might be considered desirable to have special rules governing security interests in mobile goods (such as means of transportation or self-propelled equipment, which are of such a nature that they are often used in more than one State) or in intangibles (such as book debts which have no physical manifestation and which may be recorded in a computer memory bank in a State other than that in which is located the place of business of either the debtor or the secured creditor).

24. The general rule where the secured property is neither mobile nor intangible, would probably be that the validity of the security agreement, the actions to be taken by the secured creditor in order to be protected against third parties and the degree of protection to be given against third parties would all be governed by the law of the State where the secured property was located. If the secured property was subsequently moved to a second State, the validity of the security agreement should, in principle, continue to be governed by the law of the first State. However, the second State may wish to subject the security agreement to the same requirements of formality as would otherwise be required of a security agreement concluded under the model law.

25. It is less clear what the conflict of law rule should be as to the substantive rights of the secured creditor in the secured property. In regard to the relationship between the debtor and the secured creditor, it could be argued that the law of the first State should continue to govern. However, even between the debtor and the secured creditor some of the more important questions involve the procedure to be followed by the secured creditor in case of the debtor's default. It seems probable that the law of the second State would govern these matters and that, as a result, it would be better if the entire relationship between the debtor and the secured creditor were governed by the law of the second State.

26. Similarly, any conflict between the rights of the secured creditor and any claim to the secured property by third parties (purchasers from the debtor, other creditors of the debtor or the liquidator in the debtor's bankruptcy or other insolvency proceedings) should be governed by the law of the second State. It should also be the law of the second State which governs the actions, if any, which the secured creditor must take, such as registration of the security interest, in order for his rights to be protected against third parties. However, the model law might provide that if the secured creditor had taken the appropriate actions in the first State, the second State would recognize the effect of those actions for a restricted period of time allowing the secured creditor to be repaid or to take the appropriate actions necessary, if any, in the second State.

27. If the goods were mobile goods, it could happen that the secured property was temporarily out of the State where it would normally be located at the time the events in question took place. In this case, it might be considered desirable for the law of the State where the debtor has his place of business to be the applicable law in respect of all questions. Alternatively, if the secured property were of such a nature that its ownership were registered with the State, as in the case with automobiles and trucks, it may be thought desirable that the governing law be the law of the State of registration. This would normally be the same State as the State where the debtor has his place of business, but some debtors might own vehicles in other States as well.

28. In the case of intangibles which have no physical manifestation, the rule might be similar to that in respect of mobile goods, i.e. the governing law might be the law of the State where the debtor has his place of business.

Formal requisites for a valid security agreement

29. To the extent that the security agreement is considered to be a commercial contract between the debtor and the secured creditor, there is no more reason to require that it be in writing than there is to require that a contract for a commercial sale of goods be in writing.[10] However, the essential purpose of a security agreement is to create rights in the secured property which will give the secured creditor a priority over the rights of third parties. Because of this, for the security agreement to be effective against third parties, it seems desirable that it be in writing, or if oral, confirmed in writing.

[9] See, *Official Records of the General Assembly, Thirty-second Session, Supplement No. 17* (A/32/17), annex II, para. 12 (Yearbook ... 1977, part one, II, A).

[10] E.g. United Nations Convention on Contracts for the International Sale of Goods, article 11, Vienna, 11 April 1980, provides that a contract for the international sale of goods need not be in writing (reproduced in this volume, part three, I, B, below).

30. Nevertheless, if the secured creditor takes possession of the secured property, i. e. if there is a pledge of the secured property, it may not be thought necessary that the security agreement be in writing to be effective even against third parties. As a practical matter this issue will arise in respect of commercial credit only when the secured property consists of negotiable instruments or of documents of title, such as bills of lading.

31. The advantage to requiring that the security agreement not only be in writing but that it also be authenticated is that it reduces the possibility of fraud and it makes certain the moment at which the agreement was concluded. On the other hand a requirement of authentication would make more cumbersome the process of concluding security agreements with a consequent increase in the cost. It does not seem that the extra protection against fraud is worth the cost.

Description of the claim and of the secured property

32. At the time the secured creditor attempts to enforce his security interest, it must be possible to identify the debtor and the secured creditor, the amount of the claim and the specific items of secured property. In most cases these requirements do not cause any problems. If the debtor has created a security interest in a specific item to secure repayment of the purchase price either to the seller or to a financing institution, all of these requirements will be met. Similarly, if the debtor has borrowed money and created a security interest in a specific item of property, all of these requirements will be met.

33. Difficulties arise when the secured property has been attached to immoveable property, or attached to or commingled with other moveable property, or processed to such a degree that it has changed its character. In all of these cases it seems desirable that the secured creditor not lose his security interest by virtue of the attachment, commingling or processing so long as the secured property can still be identified or traced. However, the secured creditor's rights in the secured property should be limited when exercise of those rights would seriously impair the interests of the debtor or third parties in the property to which the secured property has been attached, with which it has been commingled or into which it has been transformed.

34. The name of the secured creditor is no longer accurate when the claim for the amount still owed by the debtor accompanied by the security interest has been transferred by the original secured creditor. Therefore, the model law should provide that as regards the debtor and all third parties the original secured creditor is to be considered as the person to be paid or to be given any relevant notices unless the debtor or the third party in question has notice of the transfer or other appropriate actions to give such notice to him have been taken.

35. A different kind of problem arises under those laws on security interests which provide a means by which a security agreement can be concluded between a debtor and a secured creditor to cover a line of credit to be extended in the future. The law may provide that the security agreement specify the maximum amount of credit, but that is not always required. To the extent that funds are advanced against the line of credit, they are automatically secured under the security agreement.

36. Similarly, some laws on security interests provide that the individual items of secured property need not be described in the security agreement itself. Under legislation of this type the security interest may be in the entire business as a going concern (e. g. the *nantissement du fonds de commerce*), it may be said to "float" over described categories of secured property until the moment of enforcement at which time it attaches to the specific items then owned by the debtor, or the security interest may be said to attach to "after-acquired property" of specific types as that property is acquired by the debtor.

37. The model law should follow these examples and provide that the amount of the claim secured need not be specified in the security agreement so long as it can be determined at the time of enforcement and that it not be necessary that the description of the secured property be so detailed that the individual items could be determined at the time of the conclusion of the security agreement so long as they can be determined at the time of enforcement.

Actions required to protect security interest against third parties

38. One of the more controversial questions in respect of the law of security interests is whether the secured creditor should have to take any action in addition to concluding a valid security agreement in order to enforce the security interest against third parties in general. Such additional actions might include notation on the bill of sale in the case of a reserved title, marking of the secured property itself, marking of the buildings within which the secured property is stored or used, or filing or registration in a public office.

39. The principle purpose of requiring such an action is to give notice of the security interest to third parties before they act in the belief that the debtor has full rights in the secured property. In addition the action may have the effect of reducing fraud by the debtor and secured creditor directed against third parties.

40. Because of differences in the structure of the economy and of the nature of the secured credit typically granted, it may be desirable for different legal systems to have different rules as to the actions to be taken, or even whether any action is necessary. Moreover, within a single legal system it may be desirable to have different rules in respect of different types of transactions or in respect of different classes of third parties.

41. For example, if the secured property is part of the debtor's inventory which it is expected will be sold in the ordinary course of his business, the model law might provide that the purchaser buys the secured property free of any security interest even if he knew of it. If such were the rule, to this extent the secured creditor could take no action which would protect him against this class of third parties. His protection, if any were to be given him, might reside in a rule that the security interest automatically shifted to the proceeds of the sale.

42. Similarly, it might be thought that no form of notice to third parties need be given if the security interest were a purchase money security interest, i.e. a title reserved by the unpaid seller or held by a bank or other financing institution which supplied the funds for the purchase of the secured property.[11]

43. On the other hand if the uniform rules are drafted in such a manner as to allow the use of the inventory as a whole as secured property, either by a security interest in the entire business, a "floating" charge, or an after-acquired property clause in the security agreement, it might be thought that some form of notice to other creditors should be given of that security interest.

44. If some form of notice to third parties is to be required in respect of some or all security interests in order to protect the security interest against those third parties, the form of the notice must be decided upon. Every form of notice has its disadvantages. Marking the bill of sale is of little use as a means of informing third parties who would have to inquire of the debtor in respect of each item in question. Marking the secured property itself can be effective when the secured property consists of relatively large items intended for use and not for resale, such as industrial or office equipment, but not for other types of secured property. Marking of the building in which the secured property is used or stored is effective only if a major portion of the building is devoted to such use. Notation on a certificate of title which is transferred with the item in question is useful for those forms of property for which such certificates are normally issued, but would not be particularly useful for other types of property. Public filing or registration systems are useful for all types of property and are well thought of in some legal systems. In other legal systems they are thought to be too expensive, not to give adequate notice in fact to the appropriate third parties while making public excessive business information to third parties who have no legitimate interest in having such knowledge.

45. Whether the model law should require some form of publicity and the nature of the publicity to be required are among the more difficult questions to be decided. It may be that the only adequate solution would be to leave these matters to each State but to include in the provisions on conflict of laws that secured property which has a protected status in the first State continues to have a protected status in the second State for a restricted period of time. If by the end of that period of time the secured creditor has taken the actions required by the second State, the protected status would continue. If the actions taken in the first State were also those required by the second State (for example, notation on the certificate of title which moved with the secured property or fixing of a notice to the secured property itself), no further action would need to be taken in the second State.

Priority of security interest as against interests of third parties

46. A secured creditor who attempts to enforce the security interest at the time the debtor is in default on his obligation is likely to find that the debtor is also in default on his obligations to other parties who would also like to enforce their monetary claims by resorting to the same secured property. Therefore, the model law should state clearly the rights given to the secured creditor as against the claims of those third parties.

47. Distinctions should be drawn between different classes of secured creditors as well as between different classes of debtors. One class of secured creditor which might receive favoured status is the purchase money secured creditor. As used here the term is meant to indicate the creditor who has made available credit to the debtor to enable the debtor to purchase particular property and who has a security interest in that property to secure repayment of the credit. The purchase money secured creditor may be the unpaid seller, or may be a financing institution. Many legal systems favour unpaid sellers who reserve property in the goods sold until the price has been paid, but, except in one case, few favour the financing institution which has made the funds available. That one case is where the unpaid seller reserves title and subsequently assigns the claim and the reservation of title to the financing institution. It is suggested, however, that the financing institution should be considered to be a purchase money secured creditor even if the security interest is created by agreement between the debtor and the financing institution and not by reservation of title by the seller subsequently transferred to the financing institution.

48. Purchase money secured creditors, as described above, should be given priority over other secured creditors whose interests arise as a result of a security interest in the mass of the debtor's property.

49. Other third party creditors who may claim an interest in the secured property in conflict with the secured creditor include a party who has levied on the secured property in execution of a judgement of a court, a party who has repaired the secured property and has kept physical possession of it pending payment of the repair charges, the holder of a security interest in land to which the secured property has been attached (e.g. a machine tool which has been bolted to the floor), and the mass of creditors in bankruptcy or other insolvency proceedings. If it is decided that the secured creditor should take some action to protect himself generally against third parties, it would be necessary to decide to what extent a secured creditor who had not taken the required action would be protected against any of the third parties mentioned above.

50. In general, a secured creditor should be able to recover the secured property from a person who has purchased it from the debtor. However, if the secured property was inventory held by the debtor for resale, a purchaser of those goods should purchase free of the security interest, even if he knew of it. The secured creditor's security interest should shift automatically to the proceeds of the sale.

Proceeds

51. It is particularly appropriate that when a purchaser of inventory buys free of a security interest created in that inventory, the security interest would shift to the proceeds of the sale. However, even in those cases when the

[11] See also, paras. 47 and 48, below.

purchaser does not buy free of the security interest, it may still be desirable that the security interest would shift to the proceeds of any sale which might take place. If the secured property is in fact sold, even against the express provisions of the security agreement, it may be a practical impossibility for the secured creditor to recover the property from the purchaser and the proceeds of the sale may be the only feasible source of reimbursement to the secured creditor. Moreover, where the secured property has been destroyed by fire or similar disaster, any insurance reimbursement to the debtor should be available to the secured creditor to the extent of his unpaid claim, and this may be considered also to be proceeds.

52. Proceeds from the voluntary or involuntary disposition of the secured property can be of several different types. They can consist of cash, negotiable instruments, book accounts or other property of a nature similar to the original secured property. For example, if the secured property is an item of industrial equipment, it may be sold for cash plus a used piece of equipment. Both the cash and the used piece of equipment would be proceeds. If the used piece of equipment was in turn sold, the proceeds from that sale might also be considered to be proceeds of the original security interest.

53. So long as the proceeds can be identified as coming from the original security interest, it would be possible to consider them as being substituted for the original secured property. However, at some point of time, the cash received from the sale of the secured property, or received from the sale of the used piece of equipment taken in part payment in the original sale, becomes commingled with other cash and loses its specific identity. It might be thought that at that point of time the security interest in the proceeds would cease.

54. Conflicts of priorities can arise between the secured creditor who claims his interest in specific property of the debtor as proceeds and another secured creditor who claims a security interest in the same property based upon a different security agreement. For example, a business may have borrowed money from a factor and given as security all of its book debts then in existence or to come into existence during a particular period of time. During that period of time the business may sell on credit a piece of equipment subject to a security interest. The secured creditor in respect of the piece of equipment may claim a security interest in the resulting book debts as proceeds from the sale of the equipment while the factor may claim it under his security agreement. A decision would have to be made in such a case as to which of the two secured creditors should be given priority as to that particular book debt.

Procedures on default

55. If the debtor does not pay the debt at the time it is due, the secured creditor will look to the secured property in order to reimburse himself. Some legal systems have allowed the secured creditor who still "owned" the secured property, usually because he was a seller who had reserved title until payment was complete, to retake "his property". Other legal systems have insisted that the only purpose of retention of title is to secure the unpaid price so that the debtor, and not the secured creditor, should receive the difference between the value of the secured property and the unpaid price. In order to establish the value of the secured property, these legal systems usually require the secured property to be sold.

56. Two different concerns are reflected in the methods authorized for selling secured property after default by the debtor. On the one hand the secured property should be sold at the maximum price possible. On the other hand careful control should be exercised to ensure that the secured creditor is not allowed to take undue advantage of the distressed situation of the debtor.

57. The response of many legal systems has been to favour the second of these two concerns. The sale of secured property after default by the debtor is required to be conducted by an offical of the State or by a person specially authorized by the State to conduct such sales.

58. In some legal systems the secured creditor is authorized to sell the secured property himself. The justification for doing so is that he is more likely to be able to conduct the sale in a commercial manner and, thereby, to realize the normal commercial price for property of the type in question than would be the case if the sale were made by an official of the State. This is particularly so when the secured creditor was the original seller of the secured property and is, therefore, in the business of selling goods of the kind in question. If a private sale of the secured property on the default of the debtor is permitted by the model law, it should be required to be made according to certain standards so as to reduce the possibility of abuse by the secured creditor.