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Report of Working Group VI (Security Interests) on the work of its sixth session (Vienna, 27 September-1 October 2004)

Contents

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I. Introduction

1. At its present session, Working Group VI continued its work on the preparation of a legislative guide on secured transactions pursuant to a decision taken by the Commission at its thirty-fourth session, in 2001.[1] The Commission's decision to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.[2]

II. Organization of the session

2. The Working Group, which was composed of all States members of the Commission, held its sixth session in Vienna from 27 September to 1 October 2004. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Belgium, Brazil, Canada, China, Colombia, Croatia, Czech Republic, France, Germany, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lebanon, Lithuania, Mexico, Morocco, Nigeria, Paraguay, Poland, Republic of Korea, Russian Federation, Rwanda, Spain, Sweden, Thailand, Tunisia, Turkey, United States of America and Venezuela.

3. The session was attended by observers from the following States: Antigua and Barbuda, Bolivia, Hungary, Indonesia, Ireland, Peru, Philippines, Senegal, Slovakia, Somalia, Ukraine and Yemen.

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

(a) United Nations system: International Monetary Fund and World Bank; and

(b) International non-governmental organizations invited by the Commission: American Bar Association (ABA), Center for International Legal Studies (CILS), Commercial Finance Association (CFA), EUROPAFACTORING, International Federation of Insolvency Practitioners (INSOL), International Insolvency Institute (III), International Law Institute (ILI), Max-Planck-Institute for Foreign and Private International Law, the European Law Student's Association (ELSA) and the Federation of Latin American Banks (FELABAN).

5. The Working Group elected the following officers:

Chairman: Ms. Kathryn SABO (Canada)

Rapporteur: Mr. Madhukar Rangnath UMARJI (India).

6. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.9/Add.1 (Basic approaches to security), Add.4 (Pre-default rights and obligations), and Add.8 (Transition), A/CN.9/WG.VI/WP.11/Add.1 (Introduction and key objectives) and Add.2 (Creation), A/CN.9/WG.VI/WP.13 and Add.1 (Recommendations), as well as A/CN.9/WG.VI/WP.14 (Effectiveness against third parties), Add.1 (Priority), Add.2 (Default and enforcement) and Add.4 (Conflict of laws).

7. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of legislative guide on secured transactions.
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

8. The Working Group considered chapters I and II (Introduction and key objectives), III (Basic approaches to security), IV (Creation), V (Effectiveness against third parties), VII (Pre-default rights and obligations), IX (Default and enforcement), X (Conflict of laws) and XI (Transition). The deliberations and decisions of the Working Group are set forth below in chapters IV and V. The Secretariat was requested to revise those chapters to reflect the deliberations and decisions of the Working Group.

IV. Preparation of a legislative guide on secured transactions

Chapter III. Basic approaches to security (A/CN.9/WG.VI/WP.9/Add.1, paras. 53-62)

9. In order to have a more focused discussion and make as much progress as possible within the current session, the Working Group decided to skip the general remarks of chapter III on approaches to security (A/CN.9/WG.VI/WP.9/Add.1, paras. 1-52) and to consider the summary and recommendations (A/CN.9/WG.VI/WP.9/Add.1, paras. 53-62).

10. It was agreed that paragraphs 53 to 62, which included both a summary of the general remarks and recommendations, should be reformulated in terms of clear recommendations. It was also agreed that paragraphs 55 and 56, which dealt with non-possessory security rights and rights in intangibles, should be placed first in view of their importance. In addition, it was agreed that recommendation 57 should be revised to reflect the agreement of the Working Group to treat transfer of title for security purposes as a security device.

Chapter VII. Pre-default rights and obligations (A/CN.9/WG.VI/WP.9/Add.4, paras. 46-60, and A/CN.9/WG.VI/WP.13/Add.1, Recs. 55-57)

11. The Working Group considered the recommendations of chapter VII on pre-default rights and obligations contained in A/CN.9/WG.VI/WP.13/Add.1 (recommendations 55-57). As to the formulation of those recommendations, a

number of suggestions were made including that: recommendation 56 should be revised to refer to "public policy or the protection of third parties"; and recommendation 57 (d) should be revised to read along the following lines: "secure the discharge of a security right once the obligation that it secures has been performed".

12. With respect to recommendation 57 (c), in response to a question, it was noted that, in the absence of contrary agreement, the grantor should be able to operate its business that included using, disposing or commingling encumbered assets with other assets.

13. Subject to the changes referred to above (see para. 11), the Working Group approved the substance of recommendations 55 to 57.

Chapter XI. Transition (A/CN.9/WG.VI/WP.9/Add.8, paras. 15-22, and A/CN.9/WG.VI/WP.13/Add.1, Recs. 86-93)

14. The Working Group considered the recommendations of chapter XI on transition contained in A/CN.9/WG.VI/WP.13/Add.1 (recommendations 86-93). In response to a suggestion that the purpose section (paragraph 86) could be reformulated as a recommendation, it was noted that the purpose section prefacing each set of recommendations was intended to explain the overall objectives of those recommendations. It was also noted that the recommendations that the law should specify an effective date and include transitional rules were included in the recommendations following paragraph 86.

15. It was agreed that recommendation 87 should be revised to reflect a different approach, namely that the law, instead of specifying the effective date, could set a mechanism for specifying the effective date. It was also agreed that another consideration that might be taken into account in the determination of the effective date would be the need to give parties sufficient time to prepare for the new legislation (e.g. educate themselves, adjust their documents, etc.).

16. With respect to recommendation 93 and the relevant commentary (see A/CN.9/WG.VI/WP.9/Add.8, para. 14), on the question of whether the old regime should apply to disputes in litigation at the effective date of the new regime, it was stated that reference should be made not just to litigation but to any formal step taken towards enforcement of a security right (e.g. giving notice of default, filing a notice of enforcement in the relevant registry, etc.). In response, it was observed that such an approach might cause uncertainty since, while litigation was a determinable activity, it would be difficult to ascertain what step constituted enforcement. After discussion, it was agreed that the recommendation should be reformulated in broader terms, without referring to specific enforcement steps.

17. In the discussion, the suggestion was made that additional recommendations be included to deal with the transition from the old regime, which might not provide for registration, to the new regime, which would require registration for a security right to be effective against third parties. It was also suggested that a recommendation be included that the transition from the old to the new regime should not entail any cost other than the cost of registration.

18. Subject to the changes referred to above (see paras. 15-17), the Working Group approved the substance of recommendations 86 to 93.

Chapters I and II. Introduction and key objectives (A/CN.9/WG.VI/WP.11/Add.1, paras. 1-40, and A/CN.9/WG.VI/WP.13, Recs. 1-5)

A. Purpose (paras. 1-8)

19. It was suggested that one of the purposes of the draft Guide should be to accommodate the public policy of the enacting State with respect to debtor-creditor relations, in particular in the case of insolvency, and to codify the obligation of the parties to act in good faith and in a commercially reasonable manner (which was referred to in the purpose section of the recommendations on enforcement; see A/CN.9/WG.VI/WP.13/Add.1, para. 58 (e)). That suggestion was objected to. It was observed that, if the intention was to provide new protection, the matter could be addressed in the key objective referring to the need to balance the interests of affected persons. If, on the other hand, the intention was to avoid impairing existing public policy, that was an issue of the enacting State integrating the secured transactions law into its national system, which would, in any case, be done by the enacting State. After discussion, the Working Group agreed that the principle of public policy should be reflected in the appropriate places in the draft Guide but not in the discussion of the purpose of the draft Guide.

B. Scope (paras. 9-16)

20. With respect to paragraph 10, it was agreed that it should distinguish among categories of assets excluded and explain the reasons for their exclusion. The first category suggested for exclusion was real estate on the basis that it was not movable property. The second category that should be excluded was securities because, although they were movable property, they were subject to other law. The third category related to ships and aircraft that could be included as long as the special regimes existing were not interfered with. Another category might relate to exclusions for reasons of public policy (e.g. wages). With respect to paragraph 11, it was suggested that a reference should be included to the United Nations Convention on the Assignment of Receivables in International Trade (hereinafter referred to as "the Assignment Convention") as an example of a text prepared by UNCITRAL that provided for the creation of rights in future assets without any additional steps.

C. Terminology (para. 17)

21. With respect to the definition of "purchase money security right", it was agreed that the reference to transfer of title should be deleted to avoid inadvertently giving the impression that the main purpose of transfer of title was to provide credit for the purchase of assets.

22. With respect to the definition of "proceeds", it was agreed that a reference should be included to collections of receivables. It was also suggested that "proceeds" should refer only to proceeds received by the grantor as the secured creditor would have a right to follow the encumbered assets in the hands of a third party and a right in the proceeds received by the grantor, while it would be difficult

for third parties to find out about holders of security rights that were prior to the person from whom they received a right in the assets. After discussion, it was agreed that that question should be addressed in the recommendations dealing with proceeds rather than in the definitions (see paras. 39-41).

23. With respect to the definition of "possessory security right", it was agreed that reference should be made to tangible assets in order to clarify that negotiable instruments and negotiable documents, which were included in the definition of "tangibles", could be subject to a possessory security right.

24. With respect to the definition of "negotiable instrument" and "negotiable document", it was agreed that reference should be made also to the negotiability under the relevant law.

D. Examples of financing practices (paras. 18-28)

25. It was agreed that examples should be added of other financing practices that took various forms, including the form of transfer of title, lease or sale and leaseback arrangements. It was also agreed that paragraph 28 should focus on equipment rather than on real estate which was outside the scope of the draft Guide.

E. Key objectives (paras. 29-40)

26. There was general support in the Working Group for the key objectives in chapter II. There was also broad support in the Working Group for prefacing the recommendations of the draft Guide with a reference to the key objectives as a statement of the general principles underlying the recommendations.

27. It was also agreed that the key objective relating to the harmonization of secured transactions laws should be expanded or a new key objective should be added to refer to the need to provide conflict-of-laws rules. It was widely felt that, to the extent complete harmonization of national secured transactions laws might not be achieved, conflict rules would be particularly useful to facilitate cross-border transactions. It was also observed that conflict-of-laws rules would be useful, in any event, in order, for example, to assist parties in determining where to file.

F. Recommendations on scope (A/CN.9/WG.VI/WP.13, Recs. 1-5)

28. As to recommendation 2, it was stated that the reference to whether an obligation to be secured was determined or determinable should not be mentioned as an element defining the security rights covered by the draft Guide.

29. There was general support in the Working Group for recommendation 3 providing that the scope of the draft Guide should be as broad and comprehensive as possible.

30. With respect to recommendation 4 (b), its was stated that reference should be made to "property" rights to avoid inadvertently covering personal rights securing an obligation, such as a guarantee or suretyship.

31. With respect to recommendations 4 (c) and (d), it was stated that there was duplication as well as inconsistency between them since they both referred to all assets and recommendation 4 (c) was subject to certain exceptions while recommendation 4 (d) was not.

32. With respect to recommendation 4 (e), it was agreed that the square brackets should be deleted. It was widely felt that the draft Guide should not only take a unitary approach, covering a broad range of assets, security rights, obligations and parties but also a functional approach, covering all types of transactions performing a security function irrespective of the form of those transactions. It was stated that, unless substance prevailed over form, parties could circumvent the regime based on the recommendations of the draft Guide even with respect to the rights of third parties. It was also observed that, while a decision with respect to retention of title devices was pending, the Working Group had agreed that transfer of title and other transactions that were functionally equivalent to secured transactions should be covered.

33. In the discussion of recommendation 4, it was stated that sales of receivables might also need to be covered in some respects. It was noted that, under the Assignment Convention (see art. 2 (a)), the same rules applied to outright assignments, outright assignments for security purposes and assignments by way of security.

34. With respect to recommendation 5, it was agreed that securities should be excluded from the scope of the draft Guide as they were the subject of a convention being prepared by the International Institute for the Unification of Private Law (Unidroit) and a Convention that had been prepared by the Hague Conference on Private International Law. It was stated that, as the convention being prepared by Unidroit might not cover all relevant issues, the draft Guide might apply to issues not covered by the Unidroit convention. In response, it was noted that, as the Unidroit convention and the draft Guide were being prepared at the same time, it would be difficult to determine in time which issues might not be addressed in the Unidroit convention so that they might be addressed in the draft Guide. It was also noted that Unidroit might address issues that might not be covered in the convention being prepared in a set of principles or model legislative provisions.

35. It was also agreed that real estate should be added to the types of assets excluded in recommendation 5 from the scope of the draft Guide.

36. With respect to ships and aircraft, it was agreed that, as long as the special regimes dealing with security rights in such assets and registration was not interfered with, there was no need to exclude them from the scope of the draft Guide. It was also agreed that the commentary on the exclusions should specify the reasons for those exclusions.

37. Subject to the changes referred to above (see paras.28-36), the Working Group approved the substance of recommendations 1 to 5.

Chapter IV. Creation (A/CN.9/WG.VI/WP.11/Add.2, paras. 1-65, and A/CN.9/WG.VI/WP.13, Recs. 6-13)

A. General remarks (A/CN.9/WG.VI/WP.11/Add.2, paras. 1-65)

38. With respect to paragraph 9, it was stated that, in the absence of concrete examples of obligations subject to conditions subsequent or precedent in secured transactions, it might not be easy to understand. With respect to paragraph 30, it was

agreed that a reference should be added to collections of receivables as was done in the definition of the term “proceeds” (see para. 22).

39. With respect to paragraph 41, differing views were expressed as to whether the security right should be extended to proceeds of proceeds of the encumbered assets. One view was that the right to proceeds should be limited to proceeds received by the grantor or the secured creditor and not be extended to proceeds received by transferees. It was stated that, in the case of a sale of the encumbered assets by the grantor outside its ordinary course of business without the consent of the secured creditor, the secured creditor would have a right to follow the assets in the hands of any transferee and a right in all proceeds received by the grantor and any transferee. It was asserted that, where the secured creditor was under-secured, that would mean a windfall for the secured creditor. It was observed that the means of preventing such a windfall would be to have a rule that would limit the cumulative value of the secured creditor’s rights to the value of the original encumbered assets at the time of the event giving rise to the proceeds. Another problem that was asserted was that third parties obtaining a right in the proceeds by any of the transferees would not be able to easily ascertain the existence of a previously filed security right as any filing would be under the name of the initial grantor, not its transferees.

40. Another view, however, was that the security right should extend to any proceeds of the encumbered assets whether received by the grantor or any other party. It was stated that, as a matter of logic and consistency of the system, the security right that followed the asset in the case of unauthorized dispositions should also extend to proceeds as that was the only way to ensure adequate protection for the secured creditor who, in any case, would not receive more than what was owed. It was also observed that such an approach did not disadvantage creditors of transferees of the assets since the rule on preservation of the security right in the case of an unauthorized sale of encumbered assets put on them the burden to investigate about rights of other parties in assets offered as security, which they did as a matter of standard practice. Most importantly, it was said that if the right in proceeds were limited to proceeds received by the grantor, security rights could be undermined by a further sale of encumbered assets by a transferee receiving the assets from the grantor. A compromise proposal made to extend the security right to proceeds received from the grantor or its immediate transferees was said to raise the same problem, in particular since often the first sale of the encumbered assets was made by a grantor in distress and did not generate sufficient value, while the second or third disposition generated real value. It was also stated that the rule proposed could not work in particular in the case of a security right in receivables where, if one of the transferees collected the receivables, the secured creditor would lose both the encumbered assets and the proceeds. In response, it was observed that, where the proceeds formed part of the encumbered assets, the secured creditor would retain the right to reclaim the proceeds in the hands of the grantor or the current owner.

41. While some interest was expressed in the proposed limitation of the right in proceeds, the Working Group was not ready to make a decision. It was therefore agreed that the proposed rule should be formulated as a recommendation in square brackets with some comments for the continuation of the discussion.

B. Recommendations (A/CN.9/WG.VI/WP.13, Recs. 6-13)

42. The Working Group went on to consider the recommendations with respect to the creation of security rights on the basis of revised recommendations in document A/CN.9/WG.VI/WP.13 (Recs. 6-13).

43. With respect to recommendation 10 dealing with the requirement of a signed writing for the security agreement, it was agreed that, while possession was sufficient for the creation of possessory security rights, a writing signed by the grantor should be required for the creation of non-possessory security rights (with respect to retention of title devices the decision was postponed for a later stage). It was stated that a requirement for a writing signed by the grantor was necessary to put the grantor on notice as to the important remedies of the secured creditor with respect to the encumbered assets. It was also observed that a writing should be required to prevent post-default or post-insolvency collusion of the grantor with a creditor or the insolvency administrator.

44. It was widely felt that, in view of the minimum contents of the security agreement, as described in recommendation 9, such a form requirement would not place an undue burden on parties. In order to ensure that result, it was also agreed that the writing requirement could be met by a data message, as defined in article 6 of the UNCITRAL Model Law on Electronic Commerce, and the signature requirement could be met by a method linking the author of a message with the message, as defined in article 7 of the Model Law.

45. As to whether failure to meet the requirement for a signed writing would result in the security agreement being ineffective or impossible to prove, the Working Group decided that that matter should be left to the law of each enacting State, taking into account that the difference between those two approaches was conceptual rather than practical, since in either case the secured creditor could not exercise its rights as a secured creditor. In any case, it was agreed that failure to meet the form requirements for the security agreement did not affect the underlying secured obligation.

46. There was support in the Working Group for recommendation 12 dealing with the assets that could be encumbered and the obligations that could be secured. It was agreed, however, that more detailed recommendations should be prepared on fixtures, accessions, commingled goods and proceeds.

47. With respect to fixtures, accessions and commingled goods, it was agreed that the recommendation should be that the security right should be preserved even after they were attached to immovable or movable property, or commingled with other assets. It was also agreed that the relative rights of competing claimants should be addressed as an issue of priority. With respect to proceeds, it was suggested that the recommendations should be that: (i) unless otherwise agreed by the parties, the security right in the encumbered assets should extend to any proceeds; (ii) proceeds had to be identifiable; and (iii) tracing rules should be introduced.

48. While there was agreement in the Working Group in principle as to the right in proceeds, the concern was expressed that, in view of the fact that the term “proceeds” was defined very broadly to include even revenue flowing from the encumbered assets, the proposed rule could not only come as a surprise to the grantor but most importantly inadvertently deprive the grantor of any economic

interest in its assets. In order to address that concern, it was suggested that at least some types of revenue from the encumbered assets should be subject to the security right in the assets, only if so provided in the security agreement. It was stated that the specificity in the description of such revenue would depend on the specificity in the description of the encumbered assets (if the encumbered assets were described as "all present and after-acquired assets" or "inventory, receivables and proceeds", there would be no need for any additional reference to proceeds).

49. In the discussion, it was noted that there might be some inconsistency between the definition of the term "grantor" (see A/CN.9/WG.VI/WP.11/Add.1, para. 17 (f)), which implied that the grantor was the owner of the encumbered assets, and recommendation 12, which suggested that the grantor did not need to be the owner of the encumbered assets.

50. With respect to recommendation 13, it was agreed that the reference to the term "control" needed to be clarified by reference to its technical meaning.

51. Subject to the changes or additions mentioned above (see paras. 43, 44 and 47-50), the Working Group approved the substance of recommendations 6 to 13.

Chapter VIII. Default and enforcement (A/CN.9/WG.VI/WP.14/Add.2, paras. 1-33, and A/CN.9/WG.VI/WP.13/Add.1, Recs. 57-72)

A. General remarks (A/CN.9/WG.VI/WP.14/Add.2, paras. 1-33)

52. With respect to paragraphs 18 and 19, it was agreed that some discussion should be added to emphasize that acceptance of the encumbered assets in satisfaction of the secured obligation was particularly useful since it could save time and cost and thus maximize the realization value of the encumbered assets. It was also agreed that the need for transparency to protect the rights of the grantor and third parties should be emphasized. With respect to paragraph 20, it was agreed that the term "redemption of the encumbered assets" that was known only in some legal systems should be replaced by the more neutral term "release of the encumbered assets from the security right" by reason of the payment of the secured obligation, including interest and costs, in full.

53. With respect to paragraph 21, it was agreed that it should clarify that the source of the right of the grantor to dispose of the encumbered assets within a limited time period after default could be an agreement with the secured creditor or a rule of law. With respect to paragraph 24, it was agreed that the reference to various methods should be recast in terms of the situation in the law of various States rather than as a recommendation. It was also agreed that paragraph 24 should refer also to collections of intangibles and negotiable instruments. With respect to paragraph 28, it was agreed that, in the case of a third-party grantor, any surplus should be returned to the grantor and not to the debtor. It was also agreed that discussion should be added with respect to the intersection of movable and immovable property law (see para. 65). With respect to paragraph 31, it was agreed that the term "require" should be substituted for the term "inform".

B. Recommendations (A/CN.9/WG.VI/WP.13/Add.1, Recs. 58-72)

54. The Working Group went on to consider the recommendations with respect to default and enforcement on the basis of revised recommendations in document A/CN.9/WG.VI/WP.13/Add.1 (Recs. 58-72).

55. Broad support was expressed in the Working Group for the statement of the purpose of the recommendations on default and enforcement. The importance of ensuring expeditious realization of the value of encumbered assets, balance between efficiency and due process, flexibility for parties to agree on the appropriate enforcement mechanisms, protection of the rights of third parties and finality upon completion of enforcement proceedings were particularly emphasized. It was also widely felt that, in the absence of a credible judicial system, no enforcement procedure could work well, a point that should be made in the commentary. With respect to paragraph 58 (e), it was agreed that the reference to good faith, commercially reasonable standards and public policy should be expanded to apply to the exercise of rights and the performance of obligations of all parties.

56. With respect to recommendation 59, differing views were expressed as to whether it should be retained. One view was that it should be retained. It was stated that: as the secured creditor had a panoply of remedies based on contract and property law, the grantor (in particular individual grantors and consumers) needed to know how to cure the default and stop enforcement; notice of enforcement should be given to third parties as well (although the details of the debt might not need to be disclosed to third parties); such notice should be required at least in the case of extra-judicial enforcement; and the right of the grantor and other parties to be given notice was indispensable since it might involve the right to due process protected even under constitutional law.

57. Another view was that recommendation 59 should be deleted. It was observed that: notice of default and enforcement was a matter of contract law; the debtor knew of its default and should not be given an opportunity to delay or derail enforcement procedures; it was not advisable to establish by law cumbersome mechanisms that could have a negative impact on the realization value of encumbered assets; the nature and the details of notices might differ depending on the type of encumbered assets and security rights involved; a specific notice of disposition that had the effect of cutting off the grantor's rights in the encumbered assets should be sufficient; and consumers would not be adversely affected since consumer-protection legislation would always prevail.

58. In the discussion, various suggestions were made, including that: the notice should be in a language that was reasonably expected to be understood by its recipient (see article 16 (1) of the Assignment Convention); and that, for the purpose of informing third parties, the notice of enforcement should be registered in the secured transactions registry (that suggestion was objected to).

59. After discussion, it was agreed that: (i) recommendation 59 should be retained in square brackets as a notice of enforcement (not default which was a contractual matter to be left to contract law); (ii) its scope should be limited to extra-judicial enforcement; (iii) the legal consequences of insufficient or erroneous notices should also be addressed; and (iv) exceptions might be included to cover cases in which no notice could be given without jeopardizing the realization value of encumbered

assets. It was also agreed that the commentary should discuss the advantages and disadvantages of such a general notice of enforcement.

60. With respect to recommendation 60 (b), it was agreed that the phrase "court or other authorities" should be substituted for the phrase "official State institutions".

61. With respect to recommendation 64, it was agreed that it should be recast to refer to a right to pay the secured debt, including interest and cost, in full and to release the encumbered assets from the security right. It was also agreed that a right of reinstatement of the security right through payment of the part of the debt that was due at the time of default should not be recommended since such a right could inadvertently result in delaying and complicating the enforcement process. It was agreed, however, that the right of reinstatement could be discussed in the commentary, where reference could also be made to the limits in the exercise of such right under the laws of various countries and to reinstatement under consumer-protection law which would prevail over legislation based on the recommendations of the draft Guide. It was also agreed that the commentary should discuss the effect of payment by a third party with respect to the security right (subrogation).

62. With respect to recommendation 65, it was agreed that reference should be made to the need that any notice system should be simple, efficient, quick, inexpensive and reliable so as to avoid having a negative impact on the realization value of the encumbered assets and thus on the availability and the cost of credit. It was also agreed that the notice system should be aimed at providing protection for the grantor, but also for third parties.

63. With respect to recommendation 66, it was agreed that, instead of setting forth various procedures, it should emphasize the need for flexibility in regulating the disposition of encumbered assets subject to an independent standard, such as commercial reasonableness. It was also agreed that the commentary should discuss the right of the secured creditor to buy the encumbered asset subject to certain rules aimed at the protection of the grantor's rights.

64. As to recommendation 67, it was agreed that it should permit the secured creditor to control the collection of intangibles and negotiable instruments subject to flexible rules and the standard of commercial reasonableness.

65. With respect to recommendation 68, it was agreed that it should be recast in broader terms to deal with the intersection of movable and immovable property law and to emphasize the need for special enforcement rules that should be formulated in accordance with immovable property law and promote key objectives of movable property law, such as the need for a flexible enforcement regime and the need to promote secured credit. It was stated that the recommendation should address several questions, including: the question of whether a security right in fixtures should be enforced in accordance with movable or immovable property law; and the question of whether, in the case of security right in movable property (e.g. plant) and a mortgage in the land on which the movable property was located, enforcement of the security right in the movable property should take place in accordance with the law of movable or immovable property. It was also agreed that some discussion should be added in the commentary on recommendation 68.

66. With respect to recommendation 69, it was agreed that it should refer to the distribution of proceeds to secured creditors with a security right in the same

encumbered assets as the enforcing secured creditor and a lower priority ranking than the enforcing secured creditor. It was also agreed that the commentary could usefully explain that, in the case of doubt as to whom to turn over any surplus, the enforcing secured creditor should be entitled to make use of relevant domestic law mechanisms of the enacting State, such as payment to a public deposit fund. In addition, it was agreed that a new recommendation should be added to clarify that the exercise of remedies under secured transactions law should not prevent the secured creditor from exercising its remedies under contract law.

67. With respect to recommendation 70, it was suggested that it be revised to provide that, in the case of extra-judicial enforcement initiated by the secured creditor, any security rights with lower priority ranking than that of the enforcing secured creditor would be purged, and that a secured creditor with a higher priority ranking than that of the enforcing secured creditor should have the right to take over the enforcement procedure. As to judicial enforcement, it was suggested that all security rights should be purged and the buyer of the encumbered assets should acquire them free of any security right.

68. It was also suggested that the recommendations dealing with the disposition of encumbered assets and the taking of encumbered assets in satisfaction of the secured obligation be recast along the following lines: (i) advance notice about a non-judicial disposition or a proposal for the secured creditor to take the encumbered assets in satisfaction of the secured obligation should be given to the grantor, the debtor, secured creditors on record or in possession of the encumbered assets and any other person with rights in the encumbered assets that had notified the enforcing secured creditor; (ii) the grantor, subordinate secured creditors or other persons with subordinate rights in the encumbered assets should have a right to object to a proposal for the secured creditor to take the encumbered assets in satisfaction of the secured obligation; (iii) transferees of encumbered assets and the secured creditor who had taken the encumbered assets in satisfaction of the secured obligation should acquire the assets free of the rights of the grantor, the enforcing secured creditor, subordinate secured creditors and any person with subordinate rights in the assets; (iv) any surplus remaining after disposition must be paid to subordinate secured creditors or other subordinate claimants and, if there is a balance, to the grantor; (v) in the case of a judicial disposition of the encumbered assets, the title of the transferee and the distribution of the proceeds should be determined by the law governing enforcement proceedings by creditors generally; (vi) the first-ranking secured creditor could take control of the enforcement process; and (vii) the debtor or other person owing payment of the secured obligation should be liable for any deficiency after disposition of the encumbered assets, collection of an intangible by the secured creditor or acceptance of the encumbered assets in total or partial satisfaction of the secured obligation.

69. In response to a statement that disposition by a subordinate secured creditor would not result in clean title (i.e. free of any security rights) for the transferee and would thus not yield the maximum possible value, it was stated that the Working Group had to counterbalance the need to maximize realization value and the need to preserve the right of the first-ranking secured creditor to control the timing and manner of the enforcement of its security rights. Expressing interest in these suggestions, the Working Group requested the Secretariat to include appropriate language in the next version of the recommendations on default and enforcement.

70. With respect to recommendation 71, it was agreed that civil procedure law should not change the priority ranking secured creditors had under secured transactions law.

71. As to recommendation 72, it was agreed that the reference to transfer of title for security purposes could be deleted on the understanding that the draft Guide would make it clear that such a transfer of title should be treated in all respects as a security right.

72. Subject to the changes or additions mentioned above (see paras. 55-71), the Working Group approved the substance of recommendations 58 to 72.

Chapter X. Conflict of laws (A/CN.9/WG.VI/WP.14/Add.4, paras. 1-32, and A/CN.9/WG.VI/WP.13/Add.1, Recs. 73-85)

A. General remarks (A/CN.9/WG.VI/WP.14/Add.4, paras. 1-32)

73. With respect to paragraph 18, it was suggested that the law of the country where the goods were located should govern security rights in negotiable documents of title. That suggestion was objected to. It was widely felt that both the commentary and the recommendation on that matter (referring to the location of the document) were appropriately formulated to protect the negotiability of the document and to accommodate market needs.

74. With respect to paragraphs 21 to 25, it was stated that the commentary and the relevant recommendations needed to: (i) clarify the meaning of the reference to the law of a location at "the time when an issue arises"; (ii) specify the grace period within which a secured creditor could take any steps to preserve the effectiveness of its right against third parties in the new jurisdiction to which the goods were moved; and (iii) clarify whether the term "place of destination" meant ultimate destination only or intermediate stops as well.

B. Recommendations (A/CN.9/WG.VI/WP.13/Add.1, Recs. 73-85)

75. The Working Group went on to consider the recommendations with respect to conflict of laws on the basis of revised recommendations in document A/CN.9/WG.VI/WP.13/Add.1 (Recs. 73-85). At the beginning of its deliberations, the Working Group took note with interest of an oral report of a joint UNCITRAL-Hague Conference on Private International Law expert group meeting on applicable law issues in security interests, which was held in Vienna from 2 to 3 September 2004. Pending submission of revised versions of certain recommendations suggested by the experts, the Working Group decided to defer consideration of the relevant recommendations (77, 79, 80 and 82) until it had the opportunity to consider a revised text of those recommendations.

76. In the context of the discussion of the purpose of the recommendations on conflict of laws, the concern was expressed that the term "creation" might be confusing in countries where creation of a security right produced effects against all. In order to address that concern, the suggestion was made that the term "creation as between the parties" should be used. The Working Group noted that drafting suggestion and decided to defer its consideration until it had an opportunity to consider the chapter on creation.

77. With respect to recommendation 74, the question was raised as to whether the extinction of a security right should also be addressed. In response, it was stated that the extinction of a security right could be the result of the extinction of the secured obligation, which was a matter outside the scope of the draft Guide, or the result of application of property law and could be addressed in the draft Guide. It was agreed that that matter could be explained in the commentary with appropriate examples.

78. With respect to recommendation 75 dealing with security rights over intangible property, it was suggested that the law applicable should be the law governing the relevant claim. That suggestion was objected to. It was widely felt that such an approach would be inconsistent with the approach followed in article 22 of the Assignment Convention, which referred third party effectiveness and priority to the law of the assignor's (i.e. the grantor's) location. It was also generally felt that an approach based on the law governing the claim would be unworkable in a wide range of financing transactions that involved a multiplicity of assets, including after-acquired assets. For reasons of consistency with the Assignment Convention and in view of the importance of certainty with respect to the rights of third parties, it was also agreed that the term "location" of the grantor should be defined by reference to article 5 (h) of the Assignment Convention.

79. In response to a question, it was noted that the relevant time for the determination of the location of the grantor was addressed in recommendation 78. In response to another question, it was noted that the law applicable to security rights in certain intangible assets, such as deposit accounts, letters of credit and intellectual property rights, remained to be discussed once a decision had been reached by the Working Group as to whether they should be covered in the draft Guide (see A/CN.9/WG.VI/WP.14/Add.4, note to para. 18).

80. With respect to recommendation 76, in order to clarify that it was not designed to apply to goods in transit, it was agreed that a cross-reference should be made to recommendation 80. With respect to recommendation 80 on goods in transit, it was noted that it would be supplemented by another recommendation relating to goods intended for export.

81. While support was expressed for recommendation 78, it was agreed that its impact could be usefully explained further in the commentary. It was stated that recommendation 78 was appropriate in stating that a security right that had been created without having been made effective against third parties in State A could be made effective against third parties in State B to which the goods might have been moved.

82. It was agreed that recommendation 81 should be recast as a rule prohibiting derogation from the rules set forth in the recommendations on conflict of laws as they addressed property matters. It was also agreed that a new recommendation should be added to provide for party autonomy with respect to the mutual rights and obligations of the secured creditor and the grantor. It was further agreed that a new recommendation should be added to ensure that reference to applicable law meant reference to the material law, not the conflict of laws rules, of a State (i.e. no *renvoi*).

83. With respect to recommendation 83, a concern was expressed regarding the distinction made between substantive and procedural matters, which was a very difficult distinction to make and, in any case, would be a matter for the law of the

State where enforcement took place (*lex fori*). In order to avoid that distinction, it was suggested that reference should be made to mandatory and non-mandatory law matters and that the distinction should be left to the law of the *forum*. While some interest was expressed in the suggestion, doubt was also expressed as to whether it enhanced certainty and promoted the application of the substantive recommendations of the draft Guide on enforcement. In any case, it was stated that, as the recommendations on conflicts would most likely not be implemented by States without the substantive law recommendations of the draft Guide, the mandatory law of enacting States should be in line with the recommendations of the draft Guide on enforcement.

84. With respect to recommendation 84, it was agreed that the term "occurrence of insolvency" would be replaced by the term "commencement of insolvency proceedings in respect of the grantor".

85. Subject to the changes or additions mentioned above (see paras. 77-84), the Working Group approved the substance of recommendations 73 to 85.

Chapter V. Effectiveness against third parties (A/CN.9/WG.VI/WP.14, paras. 1-75, and A/CN.9/WG.VI/WP.13, Recs. 14-32)

A. General remarks (A/CN.9/WG.VI/WP.14, paras. 1-75)

86. The Working Group considered the general remarks of the chapter on the effectiveness of security rights against third parties (paras. 1-75) and requested the Secretariat to make the necessary changes. In particular, it was agreed that: the issue of confidentiality and the extent to which the secured creditor might be required to provide information to third parties should be treated with particular caution and that, for the time being, no recommendation should be made; the question whether the various methods of achieving third-party effectiveness were alternative or exclusive would need to be further clarified; and that the question of integration of the general secured transactions registry with the specialized title registries should be further discussed.

B. Recommendations (A/CN.9/WG.VI/WP.13, Recs. 14-32)

87. The Working Group went on to consider the recommendations with respect to the effectiveness of security rights against third parties on the basis of revised recommendations in document A/CN.9/WG.VI/WP.13 (Recs. 14-32).

88. While there was support in the Working Group for the statement of the purpose of the recommendations, it was agreed that some additional language was necessary to explain that, for a security right to be effective against third parties some additional step was necessary to the steps required for its creation as between the secured creditor and the grantor.

89. With respect to recommendation 15 on methods of achieving third-party effectiveness, it was agreed that subparagraph (c) would remain in square brackets until the Working Group had reached a final decision as to whether the intangibles obligations with respect to which third-party effectiveness could be achieved by control would be included in the scope of the draft Guide. It was also agreed that a

new paragraph should be added to indicate that there might be additional methods of achieving third-party effectiveness.

90. With respect to recommendation 17 about a general secured transactions registry, some doubt was expressed as to its necessity. With respect to recommendation 18 on the content of the notice, it was agreed that the notice should be required to include only the information set forth in recommendation 17. It was also agreed that, with respect to the duration of registration, States should be given an option to specify the duration or permit the parties to specify the duration in the notice (see Recs. 18 (c) and 25). In response to a question, it was observed that a fixed duration of registration was required to address the concern that the secured creditor would not discharge the registration in a timely manner, as well as to avoid overburdening parties and registries with unnecessary information.

91. As to whether the maximum amount for which the security right could be enforced should be mentioned in the notice, differing views were expressed. One view was that the maximum amount should be specified in the notice. It was stated that such an approach would enhance the information value of the registry and facilitate credit by subordinate creditors. Another view was that no maximum amount should be set forth in the notice. It was observed that in that way lending by the first-ranking secured creditor would be facilitated, lower-ranking creditors could lend on the basis of inter-creditor agreements and the registry would not be burdened with unnecessary information. It was also said that, if parties had to include maximum amounts in the notice, they would be inclined to inflate the relevant amounts, thus limiting the value of security available for potential lower-ranking creditors. In response, it was observed that the risk of inflated amounts was usually not an issue for equipment financing and similar specific-asset financing transactions.

92. In recognition of the merits of both views, it was suggested that the commentary on recommendation 18 (d) should discuss the advantages and disadvantages of both approaches and that the recommendation should include alternatives for States to choose from. After discussion, the Working Group decided to retain recommendation 18 (d) within square brackets for further discussion, and requested the Secretariat to elaborate further on the possible approaches in the commentary.

93. With respect to recommendation 23 on advance registration, in response to a question it was noted that advance registration could take place even at a time when the existence of a security right was in dispute. Once the existence of the right was confirmed, it would be considered as having become effective against third parties as of the time it had been registered.

94. With respect to recommendation 26 on the discharge of registration, it was agreed that the commentary should explain the meaning of “full payment or performance of the secured obligation”. It was also agreed that a new recommendation should be included providing for the discharge of registration by agreement of the secured creditor and the grantor.

95. As to whether registrations should be discharged after a summary proceeding, while there was agreement in the Working Group that there should be a speedy and effective judicial remedy for the grantor to obtain a discharge of a registration, differing views were expressed as to whether discharge should be possible by way

of administrative summary proceedings. One view was that the grantor should not have to take the time and cost to go to court where it was clear that there was no security agreement or debt. Another view was that, while in the case of an administrative process with fact-finding and law-deciding capability such an approach would be acceptable, it would not be appropriate to burden clerical staff and registrars with such responsibilities, in particular since, to minimize cost and maximize efficiency, modern registries increasingly tended to rely on computerization and a minimum of staff.

96. After discussion, the Working Group agreed that the commentary should explain that an administrative summary proceeding could be acceptable if appropriate safeguards were in place, including that the secured creditor needed to be notified and be given a right to object (in which case adjudication of the matter would be necessary). It was also stated that additional safeguards might include a statement under oath by the grantor that the debt did not exist or was paid.

97. With respect to recommendation 27, it was agreed that: discussion on recommendation 27 (a) should be postponed; recommendation 27 (b) should refer to "right" and not to "title"; recommendation 27 (b) (ii) should be retained outside square brackets; recommendation 27 (b) (v) should be deleted as the Working Group had agreed that transfer of title for security purposes should be treated as a security right; and recommendations 27 (b) (i), (iii) and (iv) should be presented as options for States. It was also agreed that the commentary would elaborate on all these points.

98. With respect to recommendation 28, it was agreed that the statement about the need for actual, not constructive, fictive or symbolic, dispossession should be strengthened and that the matter should be further elaborated in the draft Guide.

99. With respect to recommendation 29, it was agreed that the title should be corrected to refer to negotiable documents of title and that the language of the recommendation should be aligned with the definition of negotiable documents in the terminology section (see A/CN.9/WG.VI/WP.11/Add.1, para. 17 (y)). It was also agreed that the commentary would include additional explanations.

100. Pending a decision as to whether deposit accounts would be covered in the draft Guide, the Working Group agreed to postpone the discussion of recommendations 30 and 31.

101. With respect to recommendation 32, it was agreed that its formulation should be revised to conform to the distinction made in the draft Guide between the creation of a security right as between the parties and its effectiveness against third parties.

102. Subject to the changes and additions mentioned above (see paras. 87-101), the Working Group approved the substance of recommendations 14 to 32.

V. Report of the Drafting Group

103. The Working Group requested a drafting group established by the Secretariat to review the terminology of the draft Guide (A/CN.9/WG.VI/WP.11/Add.1, para.17). At the close of its deliberations, the Working Group considered and

approved the report of the drafting group. It was agreed that the definition of "security agreement" in Spanish should be aligned with the English version (i.e. the word "real" should be deleted).

VI. Future work

104. The Working Group noted that its seventh session was scheduled to take place in New York from 24 to 28 January 2005. It also noted that its eighth session was scheduled to take place in Vienna from 5 to 9 September 2005, those dates being subject to approval by the Commission at its thirty-eighth session, which was scheduled to take place in Vienna from 4 to 22 July 2005.

Notes

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 358. For a history of the project, see A/CN.9/WG.VI/WP.12, paras. 6 to 16. The reports of the first to the fifth sessions of the Working Group are contained in documents A/CN.9/512, A/CN.9/531, A/CN.9/532, A/CN.9/543 and A/CN.9/549. The reports of the first and the second joint sessions of Working Group V (Insolvency Law) and VI (Security Interests) are contained in documents A/CN.9/535 and A/CN.9/550. The consideration of those reports by the Commission is reflected in documents A/57/17 (paras. 202-204), A/58/17 (paras. 217-222) and A/59/17 (paras. 75-78).

[2] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 455, and *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 347.