United Nations A/CN.9/WG.VI/WP.21/Add.5

General Assembly

Distr.: Limited
15 June 2005

Original: English

United Nations Commission on International Trade Law
Working Group VI (Security Interests)
Eighth session
Vienna, 5-9 September 2005

Security Interests

Recommendations of the draft Legislative Guide on Secured Transactions

Note by the Secretariat

Addendum

Contents

V.05-85563 (E) 290705 010805

XI. Conflict of laws*

Purpose

The purpose of conflict-of-laws rules is to determine the law applicable to each of the following issues: the creation of a security right; the pre-default rights and obligations between the secured creditor and the grantor; the effectiveness of a security right against third parties; the priority of a security right over the rights of competing claimants; and the enforcement of a security right.

These rules should also be applicable, as appropriate, to rights that are not classified as "security rights" but which fulfil a similar economic function and are susceptible of competing with security rights, such as the rights of a transferee of receivables, a supplier of goods who retains title to the goods in a retention-of-title arrangement or a financial lessor.

[*Note to the Working Group: The Working Group may wish to note that the words "as appropriate" are intended to provide some flexibility for States following a non-unitary approach as to the manner in which they might assimilate acquisition financing devices to security devices (see A/CN.9/574, para. 34). The Working Group may also wish to recall that the words "between the parties" had been added after the word "creation" to clarify the distinction made in the Guide between "effectiveness between the parties" and "effectiveness against third parties". However, there are no two types or two times of creation, but only two types of effectiveness. Therefore, the recommendations no longer refer to creation "as between the parties". The Working Group may wish to include a footnote to the first paragraph of the purpose section that "The meaning of these terms is elaborated in chapters IV, V, VI, VII and VIII respectively".*]

Security rights in tangible property

136. The law should provide that the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in tangible property are governed by the law of the State in which the encumbered asset is located (for goods in transit and export goods, see also recommendation 142). However, with respect to security rights in tangible property of a type ordinarily used in more than one State, the law should provide that such issues are governed by the law of the State in which the grantor is located.

[*Note to the Working Group: The Working Group may wish to consider that recommendation 136 should apply to negotiable documents. As to negotiable instruments, the Working Group may wish to consider whether recommendation 136 should apply, except to the extent they are subject to a non-possessory security right in which case recommendation 137 should apply.*]

Security rights in intangible property

137. The law should provide that the creation, the effectiveness against third parties and the priority over the rights of competing claimants of a security right in

* Recommendations prepared in close cooperation with the Hague Conference on Private International Law.

intangible property are governed by the law of the State in which the grantor is located.

Security rights in proceeds from a drawing under an independent undertaking

138. [The law should provide that:

(a) Subject to subparagraphs (b) and (c), the creation, the effectiveness against third parties, the priority over the rights of competing claimants and the enforcement of a security right in the proceeds from a drawing under an independent undertaking are governed by the law of the State in which the grantor is located;

(b) To the extent that payment is sought from the issuer/guarantor or nominated person or made under an acknowledgement by the issuer/guarantor or nominated person, the effectiveness against third parties, the priority over the rights of competing claimants and the enforcement of a security right in the proceeds from a drawing under an independent undertaking are governed by the law of the State where the [relevant branch of the] payor of the proceeds is located; and

(c) The rights and duties of an issuer/guarantor or nominated person to act or not act on a request for an acknowledgement of an assignment of proceeds or on an acknowledgement made by it are governed by the law that is chosen in that person's acknowledgement or, absent an acknowledgement or a choice of law therein, by the law of the State in which that person is located and without regard to the law governing the independent undertaking itself.]

[*Note to the Working Group: The Working Group may wish to consider whether: (i) subparagraph (a) is necessary as it repeats the rule in recommendation 137; (ii) subparagraph (b) is necessary as it deals with the issue of account debtor protection addressed in recommendation 147; (iii) subparagraph (c) is necessary since it deals with a contractual matter. The Working Group may also wish to specify the meaning of location of a person for the purposes of this recommendation.*]

Security rights in bank accounts

139. [Except as otherwise provided in recommendation 140,] the law should provide that the creation, the effectiveness against third parties, the priority over the rights of competing claimants, the rights and duties of the depositary bank with respect to the security right and the enforcement of the security right in a bank account are governed by

Alternative A

the law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, the law designated in this recommendation applies only if the depositary bank has, at the time of the account agreement, an office in that State which is engaged in the regular activity of maintaining bank accounts.

[*Note to the Working Group: Alternative A is based on article 4.1 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With An Intermediary, "the Hague Convention"*.]

139 bis. If the applicable law is not determined under recommendation 139, but it is expressly and unambiguously stated in a written account agreement that the bank entered into the account agreement through a particular office, the law should provide that the law applicable to all the issues specified in recommendation 139 is the law in force in the State in which that office was then located, provided that such office then satisfied the condition specified in the second sentence of recommendation 139.

[*Note to the Working Group: This recommendation is based on article 5.1 of the Hague Convention*.]

139 ter. If the applicable law is not determined under recommendation 139 or 139 bis, that law is the law in force in the State under whose law the depositary bank is incorporated or otherwise organized at the time the written account agreement is entered into or, if there is no such agreement, at the time the bank account was opened.

[*Note to the Working Group: This recommendation is based on article 5.2 of the Hague Convention.*]

139 quater. If the applicable law is not determined under any of recommendations 139, 139 bis or 139 ter, that law is the law in force in the State in which the depositary bank has its place of business, or, if the depositary bank has more than one place of business, its principal place of business, at the time the written account agreement is entered into or, if there is no such agreement, at the time the bank account was opened.

[*Note to the Working Group: This recommendation is based on article 5.3 of the Hague Convention*.]

Alternative B

Same as alternative A but without recommendations 139 bis, 139 ter and 139 quater which could be replaced by language along the following lines: "If the applicable law is not determined under recommendation 139, the law should specify fallback rules based on article 5 of the Hague Convention."

[*Note to the Working Group: Alternative B is a simplified version of alternative A. The commentary could include the detailed fallback rules of the Hague Convention with sufficient explanation. A variation of alternative B would be to leave out of the recommendation any reference to fallback rules but instead to include and explain them sufficiently in the commentary.*]

Alternative C

the law of the State [with the closest connection to the depositary bank with which] [where] the bank account is held.

[*Note to the Working Group: Alternative C has been added at the request of the Working Group (see A/CN.9/574, para. 80). It is based on the assumption that the location of a bank account can be easily determined (for example, through an international bank account number which contains both the account number and the code of the bank with which the account is held.*]

140. [If the State in which the grantor is located recognizes registration as a method of achieving effectiveness against third parties of a security right in a bank account, the law of that State determines the effectiveness against third parties of a security right in a bank account achieved by registration.]

[*Note to the Working Group: As requested by the Working Group (see A/CN.9/574, para. 80), recommendation 140 has been added within square brackets. This recommendation would supplement recommendation 139 (regardless of which alternative is adopted) to provide that, if the State in which the grantor is located recognizes registration as a method of achieving third-party effectiveness, the effectiveness against third parties of a security right in a bank account achieved by registration would be governed by the law of the State in which the grantor is located. If adopted, this suggestion would, under those circumstances, enable a secured creditor to register a security right in a bank account in the same State in which it registers a security right in other intangible property. Recommendation 140 applies only to third-party effectiveness achieved by registration. Third-party effectiveness achieved by control or any other method would be governed by the law designated in recommendation 139 (under recommendation 63 in A/CN.9/WG.VI/WP.21/Add.1, a security right in a bank account made effective against third parties achieved by control has priority over a security right in a bank account made effective against third parties by registration)*.]

Proceeds

141. The law should provide that:

(a) The creation of a security right in proceeds is governed by the law governing the creation of the security right in the original encumbered asset from which the proceeds arose; and

(b) The effectiveness against third parties and the priority over the rights of competing claimants of a security right in proceeds are governed by the same law as the law governing the effectiveness against third parties and the priority over the rights of competing claimants of a security right in original encumbered assets of the same kind as the proceeds.

Goods in transit and export goods

142. The law should provide that a security right in tangible property (other than negotiable instruments or negotiable documents) in transit or to be exported from the State in which it is located at the time of the creation of the security right may also be created and made effective against third parties under the law of the State of the ultimate destination, provided that the property reaches that State within a specified short time period after the time of creation of the security right.

[*Note to the Working Group: As they provided for the application of the same law, the recommendations on goods in transit and export goods have been merged. The Working Group may wish to consider whether recommendation 142 should apply to all types of "tangible property", a term defined in the Guide to include negotiable instruments and negotiable documents*.]

Meaning of "location" of the grantor

143. The law should provide that, for the purposes of the recommendations in this chapter, the grantor is located in the State in which it has its place of business. If the grantor has a place of business in more than one State, the grantor's place of business is that place where the central administration of the grantor is exercised. If the grantor does not have a place of business, reference is to be made to the habitual residence of the grantor.

Relevant time when determining location

144. The law should provide that references to the location of the assets or of the grantor in the recommendations in this chapter refer, for creation issues, to that location at the time of the creation of the security right and, for third-party effectiveness and priority issues, to that location at the time the issue arises.

[*Note to the Working Group: Under recommendation 144, in the event of a change in the location of the assets or the grantor (as the case may be) after creation of a security right, third-party effectiveness and priority of the security right are governed by the law of the State in which the assets or the grantor are currently located even if all the competing claims were also created before the relocation. The Working Group may wish to consider whether an exception should be introduced pursuant to which such priority disputes would continue to be governed by the law of the original location provided that the secured creditor has taken whatever steps are necessary under that law to make its security right effective against third parties.*]

Continued third-party effectiveness upon change of location

145. The law should provide that, if a security right in encumbered assets is effective against third parties under the law of a State other than the enacting State and the location of the encumbered assets or the grantor (as relevant under the recommendations in this chapter) changes to the enacting State, the security right continues to be effective against third parties under the law of the enacting State for a period of [to be specified] days after the location of the encumbered assets or the grantor (as relevant under the recommendations in this chapter) has changed to the enacting State. If the requirements of the enacting State to make the security right effective against third parties are satisfied prior to the end of that period, the security right continues to be effective against third parties thereafter under the law of the enacting State.

[*Note to the Working Group: For the purpose of clarifying the application of recommendation 145 in the context of a priority dispute, the Working Group may wish to consider adding the following text at the end of recommendation 145: ", and, in determining priority under the law of the enacting State, for the purposes of any rule in which time of registration or other method of achieving third-party effectiveness is relevant, that time is the time at which that event occurred under the law of that other State".*]

Renvoi

146. The law should provide that the reference to "the law" of another State as the law governing an issue refers to the law in force in that State other than its conflict-of-laws rules.

Law governing the rights and obligations of the grantor and the secured creditor

147. The law should provide that the mutual rights and obligations of the grantor and the secured creditor [with respect to the security right] [, whether] arising from the security agreement [or by law,] are governed by the law chosen by them [and, in the absence of a choice of law, by the law governing the security agreement] [of the State in which the grantor is located at the time the security right was created].

[*Note to the Working Group: The Working Group may wish to note that three changes are proposed to recommendation 147, which is based on article 28 of the United Nations Assignment Convention. The phrase "with respect to the security right" aligns the scope of this provision to the subject matter of the Guide, by making the rule applicable to the parties' rights and obligations that relate to the security right. The addition of "by law" makes the rule applicable to rights and obligations relating to the security right which, although originating from the creation of the security right (and in this sense having an origin in the security agreement), arise from law in that they are not expressly or impliedly dealt with in the security agreement but become part of the security right as a matter of law. If this phrase is not added, the Guide provides no conflict-of-laws rule to determine which State's law governs this class of rights and obligations. An example would be the nature and extent of the secured party's duty to care for the collateral while it is in its possession, an obligation not strictly arising from the security agreement but part of the security right as a matter of law. As to the fallback rule applicable in the absence of a choice of law by the parties, recommendation 147 presents three alternatives. The first alternative is to provide no fallback rule on the assumption that one would not be needed since in most cases parties to secured transactions would include a choice-of-law clause in their agreements. The second alternative would be to align the law applicable to the rights and obligations of the parties with the law applicable to the purely contractual rights and obligations, an approach that would most likely be in line with the expectations of the parties. The third alternative refers to the grantor's location (which might or might not be the connecting factor under the second alternative). This third alternative might appear to provide more certainty; it might result in different laws governing the rights and obligations of the parties covered by recommendation 147 and the purely contractual rights and obligations of the parties.*]

Law governing the rights and obligations of the account debtor and the assignee

148. The law should provide that the relationship between an account debtor and the assignee of an assigned receivable, and between the transferee and the obligor under a negotiable instrument, the conditions under which an assignment of a receivable can be invoked against the account debtor or the obligor under a negotiable instrument and the determination of whether the account debtor's or obligor's obligations have been discharged are governed by the law governing the receivable or the negotiable instrument.

[*Note to the Working Group: The purpose of this recommendation is to avoid any implication that recommendation 149, which deals with the law governing enforcement of the security right against the grantor, determines the law governing enforcement by the secured creditor against the account debtor of an assigned receivable (or the obligor under a negotiable instrument)*. *However,* r*ecommendation 148, which is based on article 29 of the United Nations Assignment Convention, applies to the entire relationship between the account debtor of an assigned receivable or the obligor under a negotiable instrument and the secured creditor, matters including but not limited to enforcement.*]

Enforcement matters

149. The law should provide that:

Alternative A

Matters affecting the enforcement of a security right outside insolvency proceedings are governed by the law of the State where enforcement takes place.

Alternative B

Matters affecting the enforcement of a security right outside insolvency proceedings are governed by the law governing the security agreement [determined in accordance with recommendation 147]. However:

(a) A secured creditor may take possession of tangible encumbered assets without the consent of the person in possession of them only in accordance with the law of the State in which those assets are located at the time the secured creditor takes possession of them;

(b) A forum may apply those provisions of its own law which, irrespective of rules of conflict of laws, must be applied even to international situations; and

(c) The application of the law determined under the first sentence of this recommendation may be refused by the forum only if the effects of its application would be manifestly contrary to the public policy of the forum.

[*Note to the Working Group: Subparagraphs (b) and (c) are derived from article 11 of the Hague Convention. Subparagraph (c) refers only to the first sentence of this recommendation and not to subparagraph (a) as parties to the security agreement and third parties in the State in which the encumbered assets are located should always be able to rely on and be protected by the law of the place where the repossession of tangible encumbered assets occurs to govern such conduct and the lex fori should not override the lex situs.*]

Impact of insolvency on conflict-of-laws rules

[*Note to the Working Group: See recommendation K and note in the recommendations of this Guide on Insolvency, A/CN.9/WG.VI/WP.21/Add.3, which read as follows: "The law should provide that, notwithstanding the commencement of an insolvency proceeding, the creation, effectiveness against third parties, priority and enforcement of a security right are governed by the law that would be applicable in the absence of the insolvency proceeding. This recommendation does*

not affect the application of any insolvency rules, including any rules relating to avoidance, priority or enforcement of security rights.

[*Note to the Working Group: See also recommendations 30 and 31 of the Insolvency Guide. The commentary will clarify the relation between this recommendation, on the one hand, and recommendations 30 and 31 of the Insolvency Guide on the other hand. The commentary will also explain that this recommendation covers procedural, substantive, jurisdictional, etc., rules*.]"]

Multi-unit States

[*Note to the Working Group: The Working Group may wish to consider whether an additional recommendation is needed to provide for the application of the recommendations in this chapter in a Multi-unit State.*]

XII. Transition

Purpose

The purpose of transition provisions of the law is to provide a fair and efficient transition from the regime before the enactment of the law to the regime after the enactment of the law.

Effective date

150. The law should specify a date or a mechanism by which a date may be specified, subsequent to its enactment, as of which it will enter into force (the "effective date") in view of:

(a) The impact of the effective date on credit decisions and in particular the maximization of benefits to be derived from the law;

(b) The necessary regulatory, institutional, educational and other arrangements or infrastructure improvements to be made by the State; the status of the pre-existing law and other infrastructure;

(c) The harmonization of the law with other legislation; and

(d) The content of constitutional rules with respect to pre-effective date transactions; and standard or convenient practice for the entry into force of legislation (e.g. on the first day of a month); and

(e) The need to give affected persons sufficient time to prepare for the law.

Transition period

151. The law should provide a period of time after the effective date (the "transition period"), during which creditors with security rights effective against the grantor and third parties under the previous regime may take steps to assure that those rights are effective against the grantor and third parties under the law. If those steps are taken during the transition period, the law should provide that the effectiveness of the creditor's rights against those parties is continuous.

Priority

152. The law should provide clear rules for resolving:

(a) Which law applies to the priority between post-effective date security rights;

(b) Which law applies to the priority between pre-effective date security rights; and

(c) Which law applies to the priority between pre-effective date and post-effective date security rights.

153. The law should provide that priority between post-effective date security rights is governed by the law.

154. The law should provide generally that priority between pre-effective date security rights is governed by the former legal regime. The law should also provide, however, that application of those former rules will occur only if no event occurs after the effective date that would have changed the priority under the former regime. If such an event occurs, the law should determine priority.

155. With respect to priority between pre-effective date security rights and post-effective date security rights, the law should provide that it will apply as long as the holder of a pre-effective date right may, during the transition period, ensure priority under the law by taking whatever steps are necessary under the law. During the transition period, the priority of the pre-effective date right should continue as though the law had not become effective. If the appropriate steps are taken during the transition period, the holder of the pre-effective date right should have priority to the same extent as would have been the case had the law been effective at the time of the original transaction and those steps had been taken at that time.

156. When a dispute is in litigation (or a comparable dispute resolution system) or the secured creditor has taken steps towards enforcing its rights at the effective date of the law, the law should specify that it does not apply to the rights and obligations of the parties.

157. The law should deal with the transition from a regime in which no filing is required to a regime where filing is a condition for ensuring the effectiveness of security rights as against third parties.

158. The law should ensure that the transition should not entail any cost other than the nominal cost of registration.