United Nations A/CN.9/914/Add.4

General Assembly

Distr.: General
28 March 2017

Original: English

United Nations Commission on International Trade Law
Fiftieth session
Vienna, 3-21 July 2017

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

Note by the Secretariat

Addendum

Contents

V.17-01900 (E) 030417 040417

Chapter V. Priority of a security right

A. General rules

Article 29. Competing security rights created by the same grantor

1. Article 29 is based on recommendation 76 of the Secured Transactions Guide (see chap. V, paras. 45-54). It addresses priority competitions between security rights created by the same grantor. Article 29 divides these priority competitions into three categories. Subparagraph (a) addresses priority competitions between security rights made effective against third parties by registration of a notice in the Registry. Subparagraph (b) addresses priority competitions between security rights made effective against third parties by a method other than registration of a notice in the Registry. Subparagraph (c) addresses priority competitions between a security right that is made effective against third parties by registration of a notice in the Registry and a security right that is made effective against third parties by another method (e.g. possession).

2. Subparagraph (a), addresses the most common situation, that is, priority competitions between security rights all of which were made effective against third parties by registration of a notice in the Registry. In that situation, priority is determined by the order of registration, regardless of the order of creation (provided that the competing security rights have actually been created when the priority competition arises). Subparagraph (a) provides a simple and easy-to-apply priority rule.

3. It should be noted that the first-to-register priority rule in subparagraph (a) applies even if one or more of the competing security rights had not been created at the time of registration (registration of a notice may precede creation of a security right; see art. 4 of the Model Registry Provisions) and, thus, was not effective against third parties at the time of registration (as a security right that has not yet been created cannot be effective against third parties).

4. The following example illustrates this aspect of the first-to-register priority rule in subparagraph (a). On Day 1, before entering into a security agreement and obtaining any credit, Grantor authorized SC 1 to register, and SC 1 registered, a notice listing Grantor as the grantor and describing the encumbered assets as “all present and future equipment of Grantor”. On Day 2, Grantor entered into a security agreement with SC 2 that created in favour of SC 2 a security right in the same assets (i.e. all of Grantor’s present and future equipment) and obtained credit from SC 2, and SC 2 registered a notice with respect to that security right. On Day 3, Grantor concluded a security agreement with and borrowed money from SC 1 and created in favour of SC 1 a security right in all of Grantor’s present and future equipment. In this case, the security right of SC 2 became effective against third parties before the security right of SC 1 (because SC 1’s security right could not become effective against third parties until it was created). Yet, as a result of the first-to-register rule in subparagraph (a) the time of registration of SC 1’s notice, rather than the later time on which SC 1’s security right became effective against third parties, is used to determine priority. Thus, the security right of SC 1 has priority over the security right of SC 2 because SC 1’s notice was registered before SC 2’s notice.

5. Ordering priority according to the time of registration as opposed to the time of creation of a security right promotes efficiency and fairness for three reasons. First, the time of registration of each notice is recorded by the Registry and set out in the search result (see arts. 13, para. 3, and 23, para. 1, of the Model Registry Provisions) and is therefore easily ascertainable by third-party searchers. In contrast, the time of creation of a security right depends on background facts that are not ascertainable by a search of the Registry, and are not otherwise publicly available.

6. Second, the results that follow from the application of the rule in subparagraph (a) are consistent with the expectations of prudent secured creditors. For example, assume that SC 2 is considering extending credit to Grantor, secured by a security right in Grantor's equipment. If SC 2 searches the records of the Registry and discovers that a notice has been registered that lists Grantor as the grantor and SC 1 as the secured creditor and that describes the encumbered asset as including Grantor's equipment, SC 2 would likely expect that the registered notice reflects an existing or contemplated security right in that equipment. Accordingly, if SC 2 decides to go forward with the transaction, it will be on the understanding that its security right may be subordinate to that of SC 1.

7. Third, the rule in subparagraph (a) enables a prospective secured creditor to determine the priority of its security right over competing security rights with a level of certainty that promotes the extension of secured credit. The reason is that, if the prospective secured creditor registers a notice with respect to its security right before it actually extends credit and finds no registered notice, it can enter into a security agreement and extend credit knowing that its security right will have first priority (unless any of the exceptions to the first-to-register rule applies).

8. Subparagraph (b) addresses priority competitions in which the competing security rights have all been made effective against third parties by a method other than registration of a notice in the Registry. This situation is not very common as for most types of encumbered asset it will not be possible for two different secured creditors to both be able to make their security rights effective against third parties by a method other than registration at the same time. This is because the only other method of achieving third-party effectiveness for most types of encumbered asset will be by the secured creditor taking possession of the encumbered asset, and two different secured creditors will not both be able to have possession of the same asset at the same time. Should a competition of this type nonetheless arise, priority is determined by the order of third-party effectiveness in accordance with the general priority rule of article 29. It should be noted that where more than one secured creditor can achieve third-party effectiveness at the same time by another means is by entering into a control agreement, where this method is available (see art. 2, subpara. (g)), and, in such a situation, different priority rules apply (see, for example, arts. 47, para. 3, and 51, para. 3).

9. Subparagraph (c) addresses priority competitions between a security right that is made effective against third parties by registration of a notice in the Registry and a security right that is made effective against third parties by another method (e.g. by possession of the encumbered asset). In this situation, the time of registration of the security right that is made effective against third parties by registration is compared to the time of third-party effectiveness of the competing security right, and priority is determined according to the order of registration or third-party effectiveness. As in the case of the rule in subparagraph (a), the time of registration of a registered security right is used to determine priority even if the security right is not created until after the notice is registered (see paras. 2-4 above). For example, assume that: (a) on Day 1, SC 1 registers a notice describing an asset (with Grantor's consent); (b) on Day 2, Grantor creates a security right in the asset to SC 2, and SC 2 takes possession of the asset; and (c) on Day 3, Grantor enters into a security agreement with SC 1 that creates a further security right in the asset in favour of SC 1. Even though SC 2's security right was created first, SC 1 will have priority, because its notice was registered before SC 2 took possession.

10. There may be cases in which a secured creditor has used more than one method to make its security right effective against third parties. For example, a secured creditor in possession of an encumbered asset may subsequently register a notice with respect to that security right in the Registry, or vice versa. In this situation, the earlier priority time (i.e. when the security right was first registered or made effective against third parties) continues to be used in applying the general priority rules in article 29, unless there is a "gap" during which the security right

was neither effective against third parties nor the subject of a notice registered in the Registry (see art. 31 and para. 12 below).

Article 30. Competing security rights created by different grantors

11. Article 30 addresses priority competitions between security rights created by different grantors in the same encumbered asset. This situation can occur, for example, if a grantor creates a security right in its equipment in favour of a secured creditor (SC 1 in the example given in para. 4 above) and then sells the equipment to a person that creates a security right in it in favour of a different secured creditor (SC 2). Article 30 provides that the general priority rules in article 29 apply in this situation as well, except as provided in article 26 of the Model Registry Provisions. Under options A and B of article 26 of the Model Registry Provisions, SC 2 may have priority if SC 1 did not preserve the third-party effectiveness of its security right as against secured creditors in the position of SC 2 by taking the steps provided for in one of those options.

Article 31. Competing security rights in the case of a change in the method of third-party effectiveness

12. Article 31 addresses situations in which there has been a change in the method of third-party effectiveness (which requires that a security right has been validly created under art. 6 and that one of the methods of third-party effectiveness, set out, for example, in art. 18, has been complied with). This may happen, for example where a secured creditor makes its security right effective against third parties by possession of the encumbered asset and subsequently registers a notice with respect to its security right. In such a case, for the purposes of applying the general priority rules in article 29, the priority of the security right is determined by the time when it initially became effective against third parties so long as there was no time thereafter during which the security right was not effective against third parties. So, if the secured creditor in this example registers before it returns possession of the encumbered asset to the grantor, its priority will date from the time when it assumed possession, not the time of the later registration.

Article 32. Competing security rights in proceeds

13. Article 32 is based on recommendation 100 of the Secured Transactions Guide (see chap. V, paras. 144-150). It addresses priority competitions between security rights in assets that are proceeds (for the definition of the term “proceeds”, see art. 2, subpara. (bb)). Situations in which a secured creditor has a security right in proceeds are quite common, particularly when the original encumbered asset is inventory or a receivable, as a grantor will frequently sell inventory or collect a receivable before satisfaction of the obligation secured by that asset. In such a case, under article 10, the security right continues in the proceeds that are derived from the sale of the inventory or the collection of the receivable, and the security right in the proceeds is effective against third parties if the conditions in article 19 are satisfied. Article 32 then determines the priority of that security right as against another security right in the same asset, whether that security right is over the asset as an original encumbered asset or as proceeds. Article 32 provides that the priority of the security right in the proceeds is the same as the priority of the security right in the original encumbered asset.

14. The following example illustrates the operation of article 32. On Day 1, Grantor creates in favour of SC 1 a security right in all of Grantor’s present and future inventory and SC 1 registers a notice with respect to that security right. On Day 2, Grantor creates in favour of SC 2 a security right in all of Grantor’s present and future receivables and SC 2 registers a notice with respect to that security right. On Day 3, Grantor sells some of its inventory on credit, generating a receivable. SC 1 has a security right in that receivable under article 10 because it is proceeds of the inventory in which SC 1 had a security right and its security right in the receivable as proceeds is automatically effective against third parties under

article 19. SC 2 has a security right in that receivable as an original encumbered asset, because of its security right in present and future receivables. Under the priority rules in article 29, SC 1's security right in the receivable has priority over SC 2's security right in the receivable because the priority of SC 1's security right in the receivable (as proceeds) is determined under article 32 by the time of registration of SC 1's notice with respect to its security right in the inventory (as original encumbered assets). Thus SC 1's priority in the receivable dates from Day 1, while SC 2's priority in the receivable dates from Day 2 (for the priority of a security right in proceeds of inventory subject to an acquisition security right, see art. 41).

Article 33. Competing security rights in tangible assets commingled in a mass or transformed into a product

15. Article 33 addresses priority competitions resulting from situations in which the original encumbered assets are commingled in a mass or transformed into a product (see Secured Transactions Guide, chap. V, paras. 117-124 and recs. 90 and 91). Under article 11, a security right in the original encumbered assets automatically extends to the mass or product and, under article 20, the security right in the mass or product is automatically effective against third parties.

16. Paragraph 1 of article 33 addresses the situation in which the competing security rights that extended to the mass or product were originally in the same encumbered asset. In this situation, the order of priority of the security rights in the mass or product is the same as the order of priority of the security rights in the original encumbered asset. For example, if SC 1 has a first-ranking security right in 100,000 litres of oil and SC 2 has a second-ranking security right in the same 100,000 litres of oil and the oil is then commingled with another 100,000 litres of oil in the same tank so that the mass comprises 200,000 litres of oil, under paragraph 1 of article 33, the security right of SC 1 will continue to rank ahead of the security right of SC 2 in relation to the commingled mass. Under article 11, paragraphs 1 and 2, however, the security rights of SC 1 and SC 2 are both limited to half of the oil in the tank (i.e. 100,000 litres).

17. Paragraphs 2 and 3 address the situation in which competing security rights that extended to the mass or product were originally in different encumbered assets. In this situation, paragraph 2 provides that the secured creditors share in the mass or product according to the ratio that the obligation secured by each of their security rights bears to the sum of the obligations secured by all those security rights. Paragraph 3 provides that the determination of the value of the obligations secured by the competing security rights is subject to the limitations on the value of the obligation that is set out in article 11, paragraphs 2 and 3.

18. The following example illustrates the operation of the limitations in paragraphs 2 and 3. SC 1 has a security right in flour worth €100 to secure a loan of €100 and SC 2 has a security right in yeast worth €20, also to secure a loan of €100. The flour is mixed with the yeast to make bread. Paragraph 2 starts by providing that SC 1 and SC 2 would share in the value of the bread 50/50 (as they were both owed the same amount, i.e. €100). Paragraph 3 overrides this, however, by capping the amount of SC 2's loan, for the purposes of this calculation, at the value of the yeast (i.e. €20), so that SC 2 will only be entitled to 1/6 of the value of the bread (20/120). If the bread is worth €120 (or more), then this will not matter, as there will be sufficient value for SC 1 to recover its €100, and for SC 2 to recover its €20, in full. If the value of the bread goes down to €60 (i.e. becomes insufficient to satisfy the secured claims in full), however, then SC 1 will be paid 5/6 of the value of the bread (i.e. €50) and SC 2 will be paid only 1/6 of the value of the bread (i.e. €10).

Article 34. Security rights competing with rights of buyers or other transferees, lessees or licensees of an encumbered asset

19. Article 34 is based on recommendations 79-82 of the Secured Transactions Guide (see chap. V, paras. 60-89). It determines the rights of a buyer or other transferee, lessee or licensee of an encumbered asset vis-à-vis a security right. Paragraph 1 states the general rule is that a security right in an encumbered asset that is effective against third parties continues to encumber the asset notwithstanding its sale or other transfer, lease or licence. Paragraphs 2-6 provide exceptions to this general rule.

20. Paragraph 2 provides that, if the secured creditor authorizes the sale or other transfer of the encumbered asset free of the security right, the buyer or other transferee acquires its rights in the asset free of that security right. This rule recognizes that a secured creditor is always free to voluntarily release its security right in an asset. In practice, a secured creditor may be prepared to do this where: (a) the secured creditor and grantor have arranged for the proceeds of the sale or transfer to be remitted directly to the secured creditor in satisfaction of the secured obligation; or (b) the buyer or other transferee has agreed to assume the grantor's obligation to the secured creditor.

21. Paragraph 3 sets out a similar rule, for a situation where the secured creditor agrees that the grantor may lease or license the encumbered asset. It is stated differently than the rule in paragraph 2 (the rights of a lessee or licensee "are not affected by" the security right) because the secured creditor's authorization only entitles the lessee or licensee to enjoy undisturbed possession of the leased or licensed asset during the term of the lease or licence as opposed to acquiring ownership free of the security right as in the case of an authorized sale or other transfer.

22. Paragraph 4 provides that a buyer of a tangible asset that is sold in the ordinary course of business of the seller acquires its rights free of any security right created by the seller in that asset. It should be noted that the term "tangible asset" for the purposes of this rule excludes money, negotiable instruments, negotiable documents and certificated non-intermediated securities (see art. 2, subpara. (ll)).What constitutes a sale in the ordinary course of the seller's business requires a fact-specific analysis. Thus, for example, the sale by the grantor of some of its inventory in accordance with its usual business practices would satisfy this condition, but a one-time sale of a used item of equipment may not. It should be noted that this rule applies only to buyers, and not for other transferees. This means that it would not apply to a person that takes an encumbered asset as a gift, rather than by purchasing it. It should be also noted that a buyer of an encumbered asset sold in the ordinary course of the seller's business only takes free of security rights granted by the seller. For example, if a person acquires an encumbered asset from the grantor outside the ordinary course of the grantor's business, that person is likely to acquire the asset subject to the security right. If that person then resells the asset in the ordinary course of its business, its buyer will not acquire the asset free of the security right, even though it was sold in the ordinary course of the seller's business, because the seller had not been the grantor of the security right. This situation will most likely arise in cases where the seller's business includes the resale of used assets. The buyer's only recourse in this situation will be under other law of the enacting State (e.g. a claim for rescission of the contract or for damages).

23. A buyer may be protected by paragraph 4 even if the buyer knew of the existence of the security right. The buyer will not be protected, however, if the buyer knew that the sale breached the secured creditor's rights under its security agreement with the grantor. If, for example, a buyer knows that the seller has entered into a security agreement that limits the grantor's authority to deal in its inventory, but does not know that the sale is in breach of that limitation, the buyer can acquire the asset free of the security right.

24. Paragraphs 5 and 6 bring about similar results to those in paragraph 4 in the case of leases of tangible encumbered assets and non-exclusive licences of encumbered intellectual property that are in each case leased or licensed by the grantor in the ordinary course of its business. As with paragraph 3, the formulation of paragraphs 5 and 6 differs from the formulation of paragraph 4, because, in the case of a lease or licence concluded in the ordinary course of the grantor's business, the effect of the exception is to entitle the lessee or licensee to enjoy undisturbed use of the leased or licensed asset during the term of the lease or license as opposed to its acquiring ownership of the relevant asset.

25. Paragraphs 7 and 8 state what is often referred to as the "shelter principle". Under this principle, once a buyer or other transferee, lessee, or licensee obtains rights in the encumbered asset free of (or unaffected by) a security right, subsequent buyers or other transferees also acquire their rights in the encumbered assets free of (or unaffected by) that security right.

26. Paragraph 9 protects a buyer or lessee of low-value consumer goods that are subject to an acquisition security right that was made effective against third parties automatically under article 24 (and not, for example, by registration). In this situation, the buyer or lessee acquires its rights free of or unaffected by the security right. If a secured creditor wishes to avoid this risk, it should register a notice of its acquisition security right.

Article 35. Impact of the grantor's insolvency on the priority of a security right

27. Under article 35, a security right that is effective against third parties remains effective against third parties and retains its priority as against competing claimants notwithstanding the commencement of insolvency proceedings with respect to the grantor, except to the extent that the insolvency law to be specified by the enacting State gives superior priority to the rights of another claimant (e.g. the insolvency representative for the costs of the insolvency proceedings). This rule is extremely important in creating a legal environment that promotes the extension of secured credit, because a security right that is not recognized in insolvency proceedings, or that loses its priority because of the commencement of insolvency proceedings, is of little value to a prospective secured creditor.

Article 36. Security rights competing with preferential claims

28. Article 36 is based on recommendations 83, 85 and 86 of the Secured Transactions Guide (see chap. V, paras. 90-93 and 103-109). It provides a framework for the enacting State to implement the policy of these recommendations by requiring it to: (a) list in a clear and specific way any claims that will have priority over security rights; and (b) specify a cap on the amount of the claim given priority. This requirement is intended to ensure that secured creditors are aware of the existence of any preferential claims and their maximum amounts, and thus can take them into account before lending (for example, by deducting the potential amount of the preferential claims from the amount that they are prepared to lend based on the value of the encumbered assets on which they are relying). In specifying the preferential claims that have priority over a security right, the enacting State should also indicate whether these claims are given priority generally or only if insolvency proceedings involving the grantor are commenced (see Secured Transactions Guide, rec. 239).

29. Examples of claims that some States have determined should have priority over a competing security right include: (a) short-term claims of unpaid suppliers of goods; (b) rights of retention of unpaid creditors who have rendered services such as repair services with respect to encumbered assets; (c) claims of the grantor's employees for employment benefits; and (d) tax claims.

30. It should be noted that secured creditors typically require grantors to disclose the existence of preferential claims. However, if a grantor does not comply with this

obligation the secured creditor has only an unsecured claim against the grantor for breach of contract, and a claimant listed by the enacting State in this article as having priority retains that priority to the extent stated in this article, despite the grantor's non-compliance.

31. It should also be noted that, some States require a notice of preferential claims to be registered in the Registry. In some of those States, the priority of a registered preferential claim is subject to the general first-to-register priority rule. This approach is useful only if the registered notice states the maximum amount of the claim and the scope of the grantor's assets that are subject to that claim so as to enable potential secured creditors to make an informed decision about whether to extend credit and, if so, on what terms. In other States, registered preferential claims have priority even over security rights that were previously registered or otherwise made effective against third parties. In those States, requiring registration of preferential claims is of limited value to secured creditors (see Registry Guide, paras. 46 and 51).

Article 37. Security rights competing with rights of judgment creditors

32. Article 37 is based on recommendation 84 of the Secured Transactions Guide (see chap. V, paras. 94-102). It determines priority as between a security right in an encumbered asset and the right of a judgment creditor that has taken whatever steps are necessary to acquire rights in the grantor's assets under other law of the enacting State. Paragraph 1 gives priority to the right of the judgment creditor if the required steps are taken before the security right becomes effective against third parties. The enacting State should complete paragraph 1 by inserting the relevant steps, or a reference to the other law that specifies those steps. In some States, the relevant step may be registration of a notice of the judgment in the security rights registry. In other States, the relevant step may be seizure of the grantor's assets or service of a garnishment order on a person against whom the grantor has a claim for payment of money.

33. Paragraph 2 provides that the security right has priority over the right of the judgment creditor if the judgment creditor does not acquire rights in the encumbered asset before the security right becomes effective against third parties. The same rule applies in the rare situation in which the judgment creditor acquired its rights in the encumbered asset at the same time as the security right became effective against third parties (this may occur where the encumbered assets are future assets). This rule protects a secured creditor against the possibility that its security right might otherwise be subordinate to the right of a judgment creditor that did not exist at the time the secured creditor took the steps necessary to make its security right effective against third parties.

34. However, paragraph 2 limits the extent of the priority of the security right over the right of the judgment creditor to: (a) credit extended by the secured creditor before the expiry of a short period of time to be specified by the enacting State (e.g. 15 days) after the judgment creditor notifies the secured creditor that it has taken the steps described in paragraph 1; or (b) credit extended pursuant to an irrevocable commitment made before receipt of that notification to extend credit in a fixed amount or in an amount fixed pursuant to a specified formula. This rule prevents the secured creditor from exploiting its priority status by increasing the secured obligation even after the secured creditor acquires actual knowledge of the rights of the judgment creditor, while giving the secured creditor a short period of time to adjust to the existence of those rights.

Article 38. Acquisition security rights competing with non-acquisition security rights

35. Article 38 is based on recommendation 180 of the Secured Transactions Guide (see chap. IX, paras. 131, 136, 137, 143 and 146) and recommendation 247 of the Intellectual Property Supplement (see paras. 259-263). Two options are provided for

the enacting State. Under both options, provided that the specified conditions are satisfied, an acquisition security right has priority over a competing non-acquisition security right in the same encumbered asset including a prior non-acquisition security right that otherwise would have had priority over the acquisition security right under the general priority rules in article 29.

36. "Super-priority" for acquisition security rights is a feature of the law of most States, whether formulated as a specific priority rule as in the Model Law or, as is the case in many legal systems, as a necessary implication of ownership of the encumbered asset being retained by a seller or lessor under a retention-of-title sale or a financial lease agreement (under art. 2, subpara. (kk), a seller's or lessor's ownership rights under a retention-of-title sale or a financial lease agreement is a security right). Article 38 preserves this advantageous treatment of acquisition finance, extending it to credit supplied by bank lenders as wells as sellers and lessors.

37. Option A contains three "super-priority" rules. Which of the three rules applies will depend on the nature of the encumbered assets. The rule in paragraph 1 applies if the encumbered assets are equipment or its intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property that is primarily used or intended to be used by the grantor in the operation of its business; see art. 2, subpara. (l)). The rule in paragraph 2 applies if the encumbered assets are either inventory or its intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property held by the grantor for sale or licence in the ordinary course of the grantor's business; see art. 2, subpara. (q)). The rule in paragraph 3 applies if the encumbered assets are consumer goods or their intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property used or intended to be used by the grantor primarily for personal, family or household purposes; see art. 2, subpara. (f)).

38. Under the "super-priority" rule in paragraph 1 of option A, an acquisition security right in equipment or its intellectual property equivalent has priority over a competing non-acquisition security right created by the grantor, provided that the secured creditor has possession of the equipment or a notice with respect to the acquisition security right is registered in the Registry before the expiry of a short period of time to be specified by the enacting State (e.g. 15-20 days) after either the grantor obtains possession of the equipment or the agreement for the lease or licence of the intellectual property is concluded. If the acquisition secured creditor has possession or registers a notice with respect to the acquisition security right before the expiry of the specified period, that security right will have super-priority over a competing non-acquisition security right even if notice of the non-acquisition security right had been registered or the non-acquisition security right had been made effective against third parties before the acquisition security right (this could happen, for example, where the prior security right covered future assets). Even though possession of the equipment by the secured creditor is an alternative to timely registration for the purposes of obtaining super priority, continued possession of the equipment by the secured creditor is unlikely to be used in practice as a basis for super-priority, as this would deprive the grantor of the use of the equipment in its business. It is likely that possession will be relied on in practice only during the gap between the conclusion of the security agreement and the grantor's assumption of possession of the equipment.

39. Under the super-priority rule in paragraph 2 of option A, additional requirements must be satisfied for an acquisition security right in inventory or its intellectual property equivalent to have "super-priority" over a competing non-acquisition security right. The acquisition security right will have priority if the secured creditor has possession of the inventory, or if two conditions are met before the grantor takes possession (in the case of inventory) or the agreement for sale or licence has been concluded (in the case of the intellectual property equivalent). First a notice with respect to the acquisition security right must be registered in the

Registry. Second, a non-acquisition secured creditor that registered a notice with respect to encumbered assets of the same kind as the inventory (or its intellectual property equivalent) must have received a notice from the acquisition secured creditor. The notice must: (a) state that the acquisition secured creditor has or intends to acquire an acquisition security right; and (b) describe the relevant encumbered assets sufficiently to enable them to be reasonably identified. It should be noted that there is no grace period as in the case of equipment. It should also be noted that even though possession of inventory by the secured creditor is an alternative to the satisfaction of these two conditions for the purposes of obtaining super-priority, a secured creditor is unlikely to rely on its continued possession of inventory as a basis for super-priority, as this would deprive the grantor of the ability to sell the inventory in the course of its business. It is unlikely that possession will be relied on in practice only during the gap between the conclusion of the security agreement and the grantor's assumption of possession of delivery of the inventory.

40. There are two reasons for the different requirements for super-priority in the case of inventory or its intellectual property equivalent as compared to the conditions for super-priority in the case of equipment and its intellectual property equivalent. First, because inventory may "turn over" (i.e. be sold by the grantor) quickly and depreciate quickly, it would be inefficient for a financier extending credit that is to be secured by a non-acquisition security right in present and future inventory to have to wait for the expiry of a grace period before being certain that the grantor's inventory is not subject to an acquisition security right that will have super-priority. The requirement in paragraph 2 that the notice be registered before the grantor obtains possession of the encumbered asset addresses this concern. Second, inasmuch as new inventory can often be difficult to distinguish from old inventory, even a secured creditor with a non-acquisition security right in future inventory that monitors the ongoing acquisition of inventory by the grantor will not always be able to easily determine that new inventory has replaced similar older inventory and may thus potentially be subject to an acquisition security right. The requirement that the acquisition secured creditor give advance notice to prior-registered non-acquisition secured creditors of its pending acquisition security right addresses this concern.

41. Paragraph 4 of option A contains two important clarifications about the advance notice to be sent to prior-registered non-acquisition secured creditors under paragraph 2 (b)(ii). These clarifications are designed to facilitate acquisition financing. First, the notice may cover acquisition security rights under multiple transactions between the same parties without the need to send a new notice in relation to each new transaction. Thus, for example, where a seller or lender is planning to engage in an ongoing series of financing arrangements with the grantor, a single notice is sufficient, provided that it sufficiently describes the assets to be covered by these ongoing transactions to enable them to be reasonably identified. Second, the notice suffices only in respect of encumbered assets that are acquired by the grantor before the expiry of a time period to be specified by the enacting State (e.g. five years), after that notice is received by the non-acquisition secured creditor. As a result, an acquisition secured creditor will need to send a new notice before the expiry of the specified time period if it wants to continue to enjoy the super-priority for its acquisition financing to the grantor.

42. Under the super-priority rule in paragraph 3 of option A, an acquisition security right in consumer goods or their intellectual property equivalent automatically has priority over a non-acquisition security right that is created by the grantor in the same encumbered asset and was previously made effective against third parties. As with all the rules in article 38, it is implicit that the acquisition security right will only benefit from super-priority if it is effective against third parties. This means, for example, that a security right in consumer goods, other than low-value consumer goods, will need to be made effective against third parties by registration or possession (see arts. 18 and 24). Once it becomes effective against

third parties, the acquisition security right will have priority. A non-acquisition security right may have priority, however, if the acquisition secured creditor fails to register notice of its security right altogether (unless the low-value exemption in art. 24 applies).

43. Option B contains only two "super-priority" rules. The rule in paragraph 1 is identical to the rule in paragraph 1 of option A, except that, while paragraph 1 of option A applies only to acquisition security rights in equipment and its intellectual property equivalent, paragraph 1 of option B also applies to acquisition security rights in inventory and the intellectual property equivalent of inventory. The rule in paragraph 2 is identical to the rule in paragraph 3 of option A. Thus, the only difference between option A and option B relates to the steps that must be taken in order for an acquisition security right in inventory or in its intellectual property equivalent to have priority over a competing non-acquisition security right. Under the approach in option B, a non-acquisition secured creditor with a security right in future inventory of the grantor or its intellectual property equivalent will need to monitor the registry record if it wants to ensure, before extending new credit against new inventory or new intellectual property acquired by the grantor, that it is not the subject of an intervening acquisition security right which if registered before the expiry of the specified grace period will have super-priority. The approach in option A relieves the prior non-acquisition secured creditor from this monitoring burden, but imposes a more onerous registration and notification burden on the acquisition secured creditor.

44. The reference to possession by the secured creditor in paragraphs 1 (a) and 2 (a) of option A and paragraph 1 (a) of option B refers to the situation where the secured creditor has possession of the encumbered asset at the outset of the acquisition financing transaction, such as where the secured creditor is a seller or lessor. It does not refer to possession acquired by the secured creditor as a result of seizure in the context of enforcement upon the grantor's default. Thus, an acquisition secured creditor that failed to register in time after the grantor obtained possession of the encumbered asset cannot obtain super-priority under this article by subsequently taking possession of the encumbered asset in the context of enforcement or otherwise. Otherwise, an acquisition secured creditor could change its priority by commencing enforcement, a result that would introduce great uncertainty.

Article 39. Competing acquisition security rights

45. Article 39 is based on recommendation 182 of the Secured Transactions Guide (see chap. IX, paras. 173-178). It addresses priority competitions between acquisition security rights that are created by the same grantor in the same encumbered asset. This type of priority competition could occur in two situations. The first is where two lenders have each financed a part of the total acquisition price of the relevant asset. In this situation, priority is determined under paragraph 1 according to the general rule of priority in article 29. The second situation is where a lender advances part of the acquisition price of the encumbered asset (for example, by lending the money used by the grantor for an advance against the purchase price) with the balance of the acquisition price being financed by the supplier of the encumbered asset. In this second situation, paragraph 2 gives priority to the acquisition security right of the supplier over that of the lender, as long as it is made effective against third parties before the expiry of the period specified in article 38, paragraph 1 (b).

46. Paragraph 2 protects the supplier over the lender because credit transactions between suppliers and their customers are often entered into on a same day basis without any practical opportunity for the supplier to first check the Registry to determine whether a competing acquisition security right has been registered against the asset. Without being assured of super-priority for a limited period going forward, suppliers would be reluctant to extend secured credit to their customers and this in turn would mean that their customers would be denied access to this

important alternative source of secured credit. It should be noted that this rule applies even where the encumbered asset is inventory or its intellectual property equivalent notwithstanding that, under paragraph 2 of option A, the secured creditor must register and give notice to prior-registered non-acquisition secured creditors before the grantor obtains possession of inventory or the agreement for the sale or licence of the intellectual property equivalent of inventory is concluded in order to obtain super-priority against the holder of a prior non-acquisition security right in the encumbered asset.

Article 40. Acquisition security rights competing with the rights of judgment creditors

47. Article 40 is based on recommendation 183 of the Secured Transactions Guide (see chap. IX, paras. 145-148). It provides that an acquisition security right that is made effective against third parties before the expiry of the period specified in article 38, subparagraph 1 (b) has priority over the rights of a judgment creditor that would otherwise have priority under article 37. Where the enacting State adopts option B of article 38, article 40 ensures that acquisition secured creditors enjoy the same grace period to preserve priority over the rights of intervening judgment creditors as is available to them to establish priority over the rights of non-acquisition secured creditors.

48. By way of illustration, assume that Grantor acquires an item of equipment from Seller on credit on Day 1 and creates in favour of Seller an acquisition security right in the item of equipment to secure its obligation to pay the balance of the purchase price. On Day 5 Seller registers a notice. In the meantime, on Day 3, Judgment Creditor obtains a judgment against Grantor and takes the steps specified in article 37, paragraph 1, to acquire rights in the item of equipment. Under the rule in article 37, paragraph 1, Judgment Creditor's rights would have priority over Seller's security right because Judgment Creditor obtained its rights before Seller's security right was made effective against third parties by registration of a notice. As a result of the operation of article 40, however, Seller's security right has priority over the rights of Judgment Creditor.

49. Where the acquisition security right covers inventory and the enacting State adopts option A of article 38, the rationale for the rule in article 40 is necessarily different. This is so because paragraph 2 of option A of article 38 requires the acquisition secured creditor to register *before* the grantor obtains possession of inventory (or the agreement for the sale or licence of the intellectual property equivalent of inventory is concluded) in order to obtain super-priority against the holder of a prior *non-acquisition* security right. The rationale for giving superior protection against judgment creditors in this situation is the same as that which informs the priority rule in article 39. Because acquisition financing is often provided by suppliers as opposed to lenders, and because supplier financing is often concluded on a same-day basis, article 40 ensures that suppliers are not prevented in practice from entering into inventory financing arrangements for fear that a judgment creditor may in the coming days take the steps necessary to acquire rights in the relevant inventory so as to obtain priority under article 37.

Article 41. Competing security rights in proceeds of an asset subject to an acquisition security right

50. Article 41 is based on recommendation 185 of the Secured Transactions Guide (see chap. IX, paras. 158-172). Both option A and option B of article 38 provide that, if the specified conditions are satisfied, an acquisition security right has priority over a competing non-acquisition security right in the same encumbered asset even if the non-acquisition security right would have priority under the general priority rule in article 29. Article 41 determines whether that "super-priority" carries over to proceeds of the encumbered assets that are subject to the acquisition security right.

51. Under article 10, a secured creditor with a security right in an asset automatically has a security right in the identifiable proceeds of that asset; and, under article 19, that security right is effective against third parties if the conditions specified in that article are satisfied. Under article 32, the priority of a security right in proceeds that is effective against third parties under article 19 is the same as the priority of the security right in the original encumbered asset. Under this rule, a security right in proceeds of assets subject to an acquisition security right would have the same "super-priority" as the security right in the original encumbered asset. Article 41, however, limits the application of article 32 by restricting the "super-priority" to the proceeds of only certain types of asset subject to an acquisition security right (option A) or by not extending the "super-priority" to the proceeds at all (option B). Paragraph 1 of option A provides that the "super-priority" of an acquisition security right under article 38 generally carries over to the proceeds of those assets. This is subject, however, to the exception in paragraph 2 for proceeds of inventory or its intellectual property equivalent. Under subparagraph 2 (a), the "super-priority" does not carry over to proceeds of inventory or its intellectual property equivalent that is in the form of receivables, negotiable instruments or rights to payment of funds credited to a bank account. If the proceeds take any other form, subparagraph 2 (b) states that the acquisition security right in the proceeds will have "super-priority" if, before the proceeds arose, the non-acquisition secured creditor had previously registered a notice in the Registry with respect to a security right in an asset of the same kind as the proceeds and the non-acquisition secured creditor receives a notice from the acquisition secured creditor that states that it has or intends to obtain a security right in assets of that kind and that describes those assets sufficiently to enable them to be identified.

52. The reason why subparagraph 2 (a) does not to extend "super-priority" to proceeds of inventory (and its intellectual property equivalent) that take the form of receivables, negotiable instruments or rights to payment of funds credited to a bank account relates to the difficulty that would otherwise be faced by prior non-acquisition secured creditors with security rights in these types of assets as original encumbered assets. If the "super-priority" given to acquisition security rights were extended to those types of proceeds, potential secured creditors would be reluctant to extend credit on the basis of these types of assets as original encumbered assets for fear that their priority would be trumped by the security right of subsequent acquisition financiers in these types of assets as proceeds. The reason why subparagraph 2 (b) requires the acquisition secured creditor to send a notice to prior-registered non-acquisition secured creditors with a security right in the same kind of assets as the proceeds where the proceeds take any other form is to alert them to the existence of its prior-ranking security right in this kind of assets as proceeds so that they can decide whether to extend further credit to the grantor on the security of those assets. The decision not to provide "super-priority" with respect to these payment rights reflects a policy decision to promote receivables financing and other form of financing based upon such payment rights.

53. Option B provides that the "super-priority" with respect to assets subject to an acquisition security right does not carry over to proceeds of those assets under any circumstances. Instead, the priority of the security right in the proceeds will be determined under the general priority rules in article 29. Option B avoids the need to make the sort of distinctions between types of proceeds required to be made in option A. As already explained (see para. 27 above), article 35 provides that a security right that is effective against third parties remains effective against third parties and retains the priority it had against competing claimants notwithstanding the commencement of insolvency proceedings by or against the grantor except to the extent that the enacting State's insolvency law provides otherwise. Article 35 applies equally to the special priority accorded to acquisition security rights (see Secured Transactions Guide, rec. 186).

Article 42. Acquisition security rights extending to a mass or product competing with non-acquisition security rights in the mass or product

54. Article 42 preserves the super-priority of an acquisition security right in an asset that later becomes part of a mass or product in a way that allows the acquisition security right to extend to the mass or product under article 11 as against a competing non-acquisition security right in the mass or product as an original encumbered asset. Article 42 is subject to article 38, meaning that the super-priority of the acquisition security right is conditional on compliance with the conditions for super-priority set out in that article.

Article 43. Subordination

55. Article 43 is based on recommendation 94 of the Secured Transactions Guide (see chap. V, paras. 128-131). Paragraph 1 allows a person to subordinate its security right to a competing claim over which it would otherwise have priority. Such subordination may take the form of a bilateral agreement between the party agreeing to subordinate its security right and the competing claimant that will benefit from that subordination. However, paragraph 1 provides that the beneficiary need not be a party to the subordination. Thus, the subordination may also take the form of a unilateral commitment (usually made to the grantor) by the party agreeing to a lower priority that it will not assert its priority against a specified competing claimant or a specified class of competing claimants.

56. Paragraph 2 makes it clear that subordination does not affect the rights of competing claimants other than the party agreeing to subordinate its priority and the beneficiary of that agreement. For example, assume that three secured creditors, SC 1, SC 2 and SC 3, have security rights in the same encumbered assets, securing claims of €50, €10 and €70, respectively. Assume further that the order of priority (highest to lowest) is SC 1, SC 2 and SC 3, and that SC 1 subordinates its claim to that of SC 3. Under the rule in paragraph 2, the effect of the subordination is that SC 3 will succeed to SC 1's priority status up to €50 and that SC 2's claim to the next €10 will not be affected.

Article 44. Future advances and future encumbered assets

57. Article 44 is based on recommendations 97-99 of the Secured Transactions Guide (see chap. V, paras. 135-143). It clarifies the operation of the priority rules in this chapter in relation to a security right that secures obligations arising after the conclusion of the security agreement (see art. 7) and in relation to encumbered assets that come into existence or are acquired by the grantor after the conclusion of the security agreement.

58. Paragraph 1 provides that the priority of a security right extends to all obligations it secures, regardless of when those obligations were incurred. Thus, a security right has the same priority over the right of a competing claimant whether the entire secured obligation was incurred at or before the creation of the security right or all or a portion of the secured obligation was incurred thereafter. This rule is subject, however, to the rule in article 37, under which a judgment creditor may have priority for advances made by the secured creditor after it has knowledge that the judgment creditor has taken the steps necessary to acquire rights in the encumbered asset and has had a short period of time (set out in art. 37) to adjust. This rule is also subject to the maximum sum specified in the registered notice should the enacting State decide to require a maximum sum to be set out in the security agreement and in the registered notice.

59. Paragraph 2 similarly provides that, when a security right has been made effective against third parties by the registration of a notice, the priority resulting from that registration under article 29 extends to all the encumbered assets described in the notice whether they were owned by the grantor at the time of registration or were acquired thereafter.

Article 45. Irrelevance of knowledge of the existence of a security right

60. Article 45 is based on recommendation 93 of the Secured Transactions Guide (see chap. V, paras. 125-127). It confirms that a secured creditor's knowledge or lack of knowledge of the existence of a competing security right at the time it acquired its own security right is not relevant to the operation of the priority rules in this chapter. The point is made explicit to emphasize that priority is determined only on the basis of those priority rules and difficult-to-prove subjective states of knowledge are irrelevant. Article 45 applies only to a secured creditor's knowledge of the existence of a competing security right. Under the Model Law, however, knowledge of facts relating to the security right may be relevant in other contexts. For example, a buyer of a tangible encumbered asset sold in the ordinary course of the grantor's business that has knowledge that the particular sale breaches the rights of the secured creditor under its security agreement with the grantor does not take free of the security right; on the other hand, mere knowledge of the existence of the security right does not disqualify the buyer from protection (see art. 34, para. 4).

B. Asset-specific rules

Article 46. Negotiable instruments

61. Article 46 is based on recommendations 101 and 102 of the Secured Transactions Guide (see chap. V, paras. 154-156). Differences between article 46 and recommendations 101 and 102 are of a drafting nature only; paragraph 1 deals with the priority between competing security rights in the same negotiable instrument, and paragraph 2 addresses the rights of a secured creditor with a security right in a negotiable instrument as against a buyer or other consensual transferee of the negotiable instrument.

62. Under paragraph 1, a security right in a negotiable instrument that is made effective against third parties by the secured creditor's possession of the negotiable instrument has priority over a security right in the same negotiable instrument that is made effective against third parties by registration of a notice, whether the secured creditor took possession before or after the notice was registered. This is consistent with the important role that possession plays in ensuring negotiability under the law relating to negotiable instruments.

63. Paragraph 2 provides similar protection to a buyer or other consensual transferee that obtains possession of a negotiable instrument as against a secured creditor with a security right in the instrument that was made effective against third parties by registration of a notice. First, under paragraph 2 (a), the buyer or other consensual transferee acquires its rights free of the security right if it qualifies as a protected holder or the like under its relevant law (the enacting State should insert the appropriate term in para. 2 (a)). Second, under paragraph 2 (b), a buyer or other transferee that takes possession of the instrument and gives value for it without knowledge that the sale or other transfer violates the rights of the secured creditor under the security agreement also acquires its right in the instrument free of that security right. As with the rule in paragraph 1, this rule preserves the important role of possession in ensuring negotiability under the law relating to negotiable instruments.

64. Knowledge of the existence of a security right does not prevent a buyer or other consensual transferee of a negotiable instrument from acquiring its rights in the instrument free of the security right under paragraph 2 (b) (although such knowledge may prevent the buyer or other transferee from qualifying as a protected holder or the like and, thus, may prevent the buyer or other transferee from taking free of the security right under paragraph 2 (a)). Rather, only knowledge that the sale or other transfer violates the rights of the secured creditor under the security agreement prevents the buyer or other transferee from acquiring its rights in the instrument free of the security right under paragraph 2 (b). "Knowledge", as defined in article 2, subparagraph (r), means "actual knowledge". The reference to "good

faith" that was included in recommendation 102 (b) of the Secured Transactions Guide has been deleted on the understanding that the absence of knowledge amounts essentially to good faith in this context (and because the concept of good faith is used in the Model Law only to reflect an objective standard of conduct).

Article 47. Rights to payment of funds credited to a bank account

65. Article 47 is based on recommendations 103-105 of the Secured Transactions Guide (see chap. V, paras. 157-163). It determines priority between competing security rights in a right to payment of funds credited to a bank account whether those rights to payment are original encumbered assets or are proceeds of a security right in other property. In this respect, it should be noted that, according to art. 19, para. 1, a security right in proceeds in the form of a right to payment of funds credited to a bank account is automatically effective against third parties if the security right in the original encumbered asset is effective against third parties. Article 47 includes special priority rules because a security right in a right to payment of funds credited to a bank account may be made effective against third parties by methods other than registration (e.g. by control). Thus, there is a particular need to address priority competitions between security rights to payment of funds credited to a bank account made effective against third parties by different methods (see Secured Transactions Guide, chap. V, para. 157).

66. Paragraphs 1-3, taken together, have the effect that a security right in a right to payment of funds credited to a bank account that is made effective against third parties by any of the methods provided for in article 25 has priority over a security right that is made effective against third parties by registration of a notice in the Registry under article 18. Under paragraph 1, a security right in a right to payment of funds credited to a bank account that is made effective against third parties by the secured creditor becoming the account holder has priority over all competing security rights in the same asset. Next in the order of priority, under paragraphs 2 and 3 are: (a) a security right created in favour of the deposit-taking institution; and (b) a security right made effective against third parties by the conclusion of a control agreement between the secured creditor, the grantor and the deposit-taking institution (for the definition of the term "control agreement", see art. 2, subpara. (g) (ii)). Under paragraph 4, priority between competing security rights created in favour of secured creditors who have all concluded a control agreement is determined by the order of conclusion of the control agreements. This approach facilitates secured transactions that rely specifically on rights to payment of funds credited to a bank account by relieving secured creditors that make their security rights effective against third parties under article 25 from the general obligation of searching the Registry and from the first-to-register priority rules in article 29 (see Secured Transactions Guide, chap. V, para. 158).

67. Under paragraph 5, except when the secured creditor has become the account holder, a security right in a right to payment of funds credited to a bank account is subordinate to the deposit-taking institution's right under other law to set off its claims against the grantor against its obligation to the grantor with respect to the grantor's right to payment of funds from the bank account. The effect of this rule is to preserve the right of a deposit-taking institution to exercise its right of set-off that it has under other law.

68. Under paragraph 6, a transferee of funds from a bank account pursuant to a transfer initiated or authorized by the grantor acquires its rights free of a security right in the right to payment of funds credited to the bank account so long as the transferee does not have knowledge that the transfer violates the rights of the secured creditor under the security agreement. A "transfer of funds" includes transfers by a variety of mechanisms, including by cheque and electronic means. The purpose of paragraph 6 is to preserve the free negotiability of funds.

69. Knowledge of the existence of a security right does not prevent a transferee of funds from a bank account from taking free of the security right. Rather, it is only

knowledge that the transfer violates the rights of the secured creditor under the security agreement that prevents the transferee from taking free. “Knowledge”, as defined in article 2, paragraph (r), means “actual knowledge”. Paragraph 7 also preserves the rights of transferees of funds credited to a bank account under any other law specified by the enacting State.

Article 48. Money

70. Article 48 is based on recommendation 106 of the Secured Transactions Guide (see chap. V, para. 164). Its purpose is to preserve the negotiability of money. Thus, under paragraph 1, a transferee of encumbered money acquires its rights in the money free of the security right, unless it has knowledge that the transfer violates the rights of the secured creditor under the security agreement. “Knowledge”, as defined in article 2, paragraph (r), means “actual knowledge”. Paragraph 2 also preserves the rights of persons in possession of money under any other law specified by the enacting State.

Article 49. Negotiable documents and tangible assets covered by negotiable documents

71. Article 49 is based on recommendations 108 and 109 of the Secured Transactions Guide (see chap. V, paras. 167-169). It is intended to preserve the widely recognized practice under which rights to tangible assets that are covered (or represented) by a negotiable document are subsumed in the negotiable document with the result that persons that acquire rights in the document thereby also acquire rights in the assets covered by the document. Accordingly, under paragraph 1, a security right in a tangible asset that is made effective against third parties by possession of the negotiable document covering that asset has priority over a competing security right in the tangible asset that is made effective against third parties by any other means.

72. Paragraph 2 states an exception to that general rule. Except when the encumbered asset is inventory, it provides that the rule in paragraph 1 does not apply to a security right in a tangible asset that is made effective against third parties before the earlier of: (a) the time when that asset became covered by the negotiable document; or (b) the time of conclusion of the agreement between the grantor and the secured creditor in possession of the negotiable document so long as the asset actually became covered by the negotiable document before the expiry of a short period of time thereafter to be specified by the enacting State (e.g. seven days).

Article 50. Intellectual property

73. Article 50 is based on recommendation 245 of the Intellectual Property Supplement (see paras. 193-212). Its purpose is to clarify that the rule in article 34, paragraph 6, does not obviate other rights of the secured creditor in its capacity as an owner or licensor of the intellectual property that is the subject of the licence under other law relating to intellectual property to be specified by the enacting State. For example, the Model Law does not affect any right that a licensor may have to terminate a licence agreement for non-compliance by the licensee (see Intellectual Property Supplement, paras. 23-25 and 196). This clarification is of particular importance because the concept of “ordinary course of business”, used in article 34, paragraph 6, is a concept of commercial law and is not drawn from law relating to intellectual property and thus may create confusion in an intellectual property context. Typically, law relating to intellectual property does not distinguish in this respect between exclusive and non-exclusive licences and focuses rather on the issue of whether a licence has been authorized or not.

74. It should be noted that article 50 makes no reference to the rights of secured creditor in its capacity as a secured creditor under other law relating to intellectual property. This is so because, if the Model Law is in this respect inconsistent with

law relating to intellectual property, the Model Law (including art. 50) would not apply (see art. 1, para. 3 (b)); and, if the Model Law (including art. 50) is not inconsistent with law relating to intellectual property and does apply, article 34 would generally apply to rights of a secured creditor under the Model Law without affecting the effectiveness of a security right in licensed intellectual property, its priority as against a competing claimant other than a non-exclusive licensee, or the post-default rights of a secured creditor under the Model Law that do not affect the rights of the licensee (see Intellectual Property Supplement, para. 203).

75. As a result, depending on the content of law relating to intellectual property, unless the secured creditor authorized the grantor to grant licences unaffected by the security right, the licensee may only take the licence subject to the security right, rather than free of it. This would mean that, if the grantor defaults, the secured creditor would be able to enforce its security right in the licensed intellectual property and sell or license it free of the licence. As a consequence, a person obtaining a security right from the licensee will only obtain a security right of limited value, as the encumbered licensed intellectual property may cease to exist if the licensor's secured creditor enforces its security right (following default by the licensor under its security agreement with the secured creditor).

Article 51. Non-intermediated securities

76. Article 51 covers security rights in non-intermediated securities. This is a type of encumbered asset not addressed in the Secured Transactions Guide, which excluded from its scope security rights in all types of securities (see rec. 4 (c)). Article 51 adjusts the general priority rules in article 29 in a manner similar to the special priority rules for security rights in negotiable instruments (for certificated securities) and rights to payment of funds credited to a bank account (for uncertificated securities).

77. For certificated non-intermediated securities, paragraph 1 provides that a security right that is made effective against third parties by the secured creditor's possession of the certificate has priority over a competing security right created by the same grantor that is made effective against third parties by registration of a notice in the Registry. This is parallel to the rule for negotiable instruments in article 46, paragraph 1 and similarly reflects the negotiable character of this type of encumbered asset (the term "certificated non-intermediated securities" is defined in art. 2, para. (d) in a manner that reflects its negotiable character).

78. For uncertificated non-intermediated securities, paragraph 2 provides that a security right that is made effective against third parties by registration in the books maintained for that purpose by or on behalf of the issuer has priority over a security right in the same securities that is made effective against third parties by any other method (e.g. by registration of a notice in the Registry). Depending on the applicable law (see art. 100), registration in the books of the issuer may take the form of a notation of the security right or an entry of the name of the secured creditor as the holder of the securities. The enacting State should specify the form of registration method that best fits its law. If that law provides for both forms of registration, both could be retained. This priority rule is similar to the rule for rights to payment of funds credited to a bank account in article 47, paragraph 1. The rationale for this rule is that such registration in the books of the issuer fulfils a similar function to the secured creditor becoming the account holder of a bank account.

79. The priority rules in paragraphs 3 and 4 also apply only to uncertificated non-intermediated securities. They parallel the rules for security rights in rights to payment of funds credited to a bank account in article 47, paragraphs 3 and 4. Paragraph 3 gives priority to a security right that is made effective against third parties by the conclusion of a control agreement over a competing security right in the same securities made effective against third parties by another method (e.g. by registration of a notice in the Registry). As between competing security rights made

effective against third parties by the conclusion of a control agreement, paragraph 4 awards priority in the order in which the control agreements were concluded (for the definition of the term “control agreement, see art. 2, subpara. (g)(i)).

80. Unlike article 46, paragraph 2, article 47, paragraphs 6 and 7, and article 49, paragraph 3, which provide a priority rule protecting transferees and then defer to other law that may provide them with better rights, paragraph 5 does not include a priority rule but instead defers to the law relating to the transfer of securities to be specified by the enacting State. The reason for this approach is that national law diverge widely with respect to the protection of holders of non-intermediated securities and the matter does not lend itself to unification at the international level. It should be noted that, if the enacting State neither has nor is prepared to introduce a law relating to the transfer of securities, it may not need to implement paragraph 5.