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Report of Working Group VI (Security Interests) on the work of its fourth session (Vienna, 8 - 12 September 2003)

Contents

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I. Introduction

1. At its present session, the Working Group continued its work on the development of "an efficient legal regime for security rights in goods involved in a commercial activity".[1] The Commission's decision to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.[2]

2. At its thirty-third session (2000), the Commission discussed a report prepared by the Secretariat on issues to be addressed in the area of secured credit law (A/CN.9/475). At that session, the Commission agreed that secured credit law was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of its close link with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. It was also widely felt that modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries, and in the share such parties had in the benefits of international trade. A note of caution was struck, however, in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. Furthermore, it was stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable.[3]

3. At its thirty-fourth session (2001), the Commission considered another report prepared by the Secretariat (A/CN.9/496) and agreed that work should be undertaken in view of the beneficial economic impact of a modern secured credit law. It was stated that experience had shown that deficiencies in that area could have major negative effects on a country's economic and financial system. It was also stated that an effective and predictable legal framework had both short- and long-term macroeconomic benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth. Indeed, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.[4] As to the form of work, the Commission considered that a model law would be too rigid and noted the suggestions made for a set of principles with a legislative guide that would include legislative recommendations.[5]

4. At its first session (New York, 20-24 May 2002), the Working Group considered chapters I to V and X (A/CN.9/WG.VI/WP.2 and Addenda 1 to 5 and 10) of the first preliminary draft guide on secured transactions, prepared by the Secretariat. At that session, the Working Group requested the Secretariat to prepare revised versions of those chapters (see A/CN.9/512, para. 12). At that session, the

Working Group also considered suggestions for the presentation of modern registration systems in order to provide the Working Group with information necessary to address concerns expressed with respect to registration of security rights in movable property (see A/CN.9/512, para. 65). At the same session, the Working Group agreed on the need for coordination with Working Group V (Insolvency Law) on matters of common interest and endorsed the conclusions of Working Group V with respect to those matters (see A/CN.9/512, para. 88).

5. At its thirty-fifth session (2002), the Commission considered the report of the first session of the Working Group (A/CN.9/512). It was widely felt that the legislative guide represented a valuable opportunity for the Commission to assist States in adopting modern secured transactions legislation, which was generally thought to be a necessary, albeit not sufficient in itself, condition for increasing access to low-cost credit, thus facilitating the cross-border movement of goods and services, economic development and ultimately friendly relations among nations. In that connection, the Commission noted with satisfaction that the project had attracted the attention of international, governmental and non-governmental organizations and that some of those took an active part in the deliberations of the Working Group. At that session, the Commission also felt that the timing of the Commission's initiative was most opportune both in view of the relevant legislative initiatives under way at the national and international levels and in view of the Commission's own initiative in the field of insolvency law. After discussion, the Commission confirmed the mandate given to the Working Group at its thirty-fourth session to develop an efficient legal regime for security rights in goods, including inventory. The Commission also confirmed that the mandate of the Working Group should be interpreted widely to ensure an appropriately flexible work product, which should take the form of a legislative guide.[6]

6. At its second session (Vienna, 17-20 December 2002), the Working Group considered chapters VI, VII and IX (A/CN.9/WG.VI/WP.2 and Addenda 6, 7 and 9) of the first preliminary draft guide on secured transactions, prepared by the Secretariat. At that session, the Working Group requested the Secretariat to prepare revised versions of those chapters (see A/CN.9/531, para. 15). In conjunction with that session and in accordance with suggestions made at the first session of the Working Group (see A/CN.9/512, para. 65), an informal presentation of the registration systems of security rights in movable property of New Zealand and Norway was held. Immediately before that session, Working Groups V (Insolvency Law) and VI (Security Interests) held their first joint session (Vienna, 16-17 December 2002), during which the revised version of former chapter X (new chapter IX; A/CN.9/WG.VI/WP.6/Add.5) on insolvency was considered. At that session, the Secretariat was requested to prepare a revised version of that chapter (see A/CN.9/535, para. 8).

7. At its third session (New York, 3-7 March 2003), the Working Group considered chapters VIII, XI and XII of the first preliminary draft guide on secured transactions (A/CN.9/WG.VI/WP.2/Add.8, A/CN.9/WG.VI/WP.2/Add.11 and A/CN.9/WG.VI/WP.2/Add.12) and chapters II and III (paras. 1-33) of the second version of the draft guide (A/CN.9/WG.VI/WP.6/Add.2 and A/CN.9/WG.VI/WP.6/Add.3) and requested the Secretariat to prepare revised versions (A/CN.9/532, para. 13).

8. At its thirty-sixth session in 2003, the Commission had before it the reports of Working Group VI (Security Interests) on the work of its second and third sessions (A/CN.9/531 and A/CN.9/532), as well as the report of the first joint session of Working Group V and VI (A/CN.9/535). The Commission noted with appreciation the progress made by the Working Group in its work.[7]

II. Organization of the session

9. The Working Group, which was composed of all States members of the Commission, held its fourth session in Vienna from 8 to 12 September 2003. The session was attended by representatives of the following States members of the Commission: Austria, Benin, Brazil, Burkina Faso, Cameroon, Canada, China, Colombia, Fiji, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Mexico, Morocco, Paraguay, Romania, Russian Federation, Rwanda, Sierra Leone, Singapore, Spain, Sudan, Sweden, Thailand, the Former Yugoslav Republic of Macedonia, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay (alternating annually with Argentina).

10. The session was attended by observers from the following States: Argentina, Australia, Costa Rica, Côte d'Ivoire, Czech Republic, Ghana, Indonesia, Lebanon, Libyan Arab Jamahiriya, Nigeria, Peru, Poland, Republic of Korea, Switzerland, Turkey, Ukraine and Venezuela.

11. The session was also attended by observers from the following national or international organizations: (a) organizations of the United Nations system: International Monetary Fund (IMF), the World Bank; (b) intergovernmental organizations: Asian Clearing Union; National Law Center for Inter-American Free Trade (NLCIFT); (c) non-governmental organizations invited by the Commission: American Bar Association (ABA), Center for International Legal Studies, Commercial Finance Association (CFA), Europafactoring, International Chamber of Commerce (ICC), International Federation of Insolvency Professionals (INSOL) and Max-Planck-Institute of Foreign and Private International Law.

12. The Working Group elected the following officers:

Chairman: Ms. Kathryn SABO (Canada)

Rapporteur: Mr. Norbert Csizmazia (Hungary)

13. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.8 (provisional agenda), A/CN.9/WG.VI/WP.6 and Addenda 1, 3, as well as A/CN.9/WG.VI/WP.9 and Addenda 1 to 4 and 6 to 8 .

14. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Preparation of a legislative guide on secured transactions.
4. Other business.
5. Adoption of the report.

III. Deliberations and decisions

15. The Working Group considered chapters IV (Creation), IX (Insolvency), I (Introduction), II (Key Objectives), and paragraphs 1 to 41 of chapter VII (Priority of the draft guide. The deliberations and decisions of the Working Group are set forth below in part IV. The Secretariat was requested to prepare, on the basis of those deliberations and decisions, a revised version of the chapters of the draft guide discussed at this session.

IV. Preparation of a legislative guide on secured transactions

Chapter IV. Creation (A/CN.9/WG.VI/WP.6/Add.3)

A. Enterprise mortgages and floating charges (paras. 27-33)

16. Recalling that, at its third session, it had considered paragraphs 1 to 33 of chapter IV (see A/CN.9/532, para. 108), the Working Group resumed its deliberations on the issue of enterprise mortgages.

17. The Working Group agreed that the section should be revised to provide a balanced outline of the advantages and disadvantages of the enterprise mortgage concept. It was stated that the main advantage of an enterprise mortgage type of security right was that it allowed an enterprise that had more value as a whole to obtain more credit and at a lower cost. On the other hand, it was observed that an enterprise mortgage might limit the ability of the debtor to obtain credit from other sources and raise the cost of that credit to the extent that other creditors were unprotected. It was said, in some countries, limitations had been introduced to the scope of enterprise mortgages, in terms of a percentage at the value of the enterprise, in the case of insolvency. In response, it was observed that the economic impact and the placement of any such limitations in the draft guide should be carefully considered. It was also stated that any limitations should be part of insolvency law and discussed in the draft guide on Insolvency Law and in the chapter on Insolvency of the draft guide on Secured Transactions.

18. With regard to the note following paragraph 33, there was general agreement in the Working Group that the appointment of an administrator could be made by agreement between the debtor and the secured creditor or by a court. It was suggested that such appointment could also be made by the debtor. It was agreed that appointment of an administrator related to enforcement in and outside of an insolvency proceeding and, while reference should be made in the chapter on Creation to the ability of the parties to a security agreement to agree to the appointment of an administrator in the enforcement of an enterprise mortgage outside of insolvency, a full and detailed discussion of the issue was best placed in the chapter on Default and Enforcement.

19. As to whether the administrator would act outside an insolvency proceeding in the interest of the secured creditor only or of all creditors, differing views were expressed. One view was that the administrator would act in the interest of the secured creditor since the appointment was a method of enforcement of the security right. If that caused other creditors to be concerned, they could apply to the court to have the debtor declared insolvent. Another view was that, as the appointment was intended to preserve the value of the enterprise as a going concern and was very

close to insolvency, the administrator would act in the interest of all creditors, in particular in the case of an administrator appointed by the debtor to reorganize the enterprise. It was stated that such a method of enforcement was very close to insolvency and raised also the issue of applicability of avoidance actions.

20. With regard to paragraph 28, the Working Group agreed that, while the last sentence was true of many States, additional language might be added to the effect that the discussion in the draft guide only concerned movables and did not prevent a State from allowing an enterprise mortgage to include immovables.

21. As to paragraph 32, it was stated that the pre-insolvency priority of an enterprise mortgage type of interest should not be changed and that, if such changes were made, they should be limited and transparent. In response, it was observed that recent legislation in some countries had limited such priority to a part of the total value of the enterprise so as to protect other creditors (see para. 17 above).

22. While support was expressed for paragraph 33, differing views were expressed as to whether it should be recast as a recommendation. In support of a recommendation along the lines of paragraph 33, it was stated that an all-asset security was a useful tool in a modern secured transactions system. In opposition to such a recommendation, it was observed that an all-asset security created the risks of over-collateralization and creditor monopoly.

B. Fixtures (paras. 34-35)

23. While it was agreed that paragraphs 34 and 35 addressed an important matter, a number of concerns were expressed. One concern was that those paragraphs were misplaced in the chapter on Creation since they essentially addressed issues of publicity and priority. Another concern was that the discussion in those paragraphs was not complete since cases, where a movable was attached to another movable (accession) or where movables were processed, were not addressed. Yet another concern was that the ease of separation might not be appropriately judged on the basis of technical difficulty and cost.

24. In response to a question, it was noted that the relationship between a right in immovables and a right in related intangibles (e.g. rents), was addressed in the chapter on Priority. In response to another question, it was noted that special publicity for fixtures was addressed in the chapter on Publicity.

C. Proceeds (paras. 36-47)

25. A number of suggestions were made with regard to paragraphs 36 to 47. One suggestion was that paragraph 41 should be supplemented with a reference to the reason for recognizing a right in civil or natural fruits (i.e. the expectation of the secured creditor to receive the income generated by the encumbered assets). Another suggestion was that paragraph 43 should clearly refer to the publicity system recommended in the draft guide. Yet another suggestion was that paragraph 46 should refer to the fact that, as the proceeds took the place of the encumbered assets, the proprietary nature of the right of the secured creditor in proceeds of the encumbered assets was the natural result of the proprietary nature of the security right. Another suggestion was that, while allowing rights in proceeds was bound to

result in conflicts between, for example, inventory and receivables financiers, it was important for practice to recognize such rights in proceeds.

26. As to the notes in paragraphs 44 and 45, it was agreed that they raised important issues that should be addressed in the draft guide. It was stated, however, that the issue of tracing in paragraph 45 was more important than the issue of timing in paragraph 44. It was also observed that assets would be proceeds or not, and that paragraph 44, combined with paragraph 72, might be misleading in that it unnecessarily added a third possibility, namely that assets would be "identifiable proceeds" (or "readily identifiable proceeds"). It was also pointed out that the principles adopted with respect to encumbered assets (e.g. concerning a generic description and the possibility of granting a security right in after-acquired assets) should also apply to proceeds, and that accordingly all that should be required was that the creditor proved that the proceeds were its encumbered assets. In addition, it was suggested the draft guide should discuss whether the right in proceeds was granted by law or by agreement. It was stated that it was a matter of convenience of the parties rather than a policy issue for the legislator, and that the draft guide should provide for both possibilities.

27. In response to a suggestion that the proceeds rules in the draft guide might follow the proceeds rules in the United Nations Convention on the Assignment of Receivables in International Trade ("the United Nations Assignment Convention"), it was observed that that approach might not be appropriate as the proceeds rules in the United Nations Assignment Convention were conflict-of-laws rules.

D. Security agreement (paras. 48-60)

28. It was stated that, in its generality, the statement in the second sentence in paragraph 48 that an additional act was required "in most legal systems" for the security right to be created might not be accurate. It was also observed that the statement in the second sentence of paragraph 49 might also not be accurate since a security right could be created automatically if the security agreement provided for that result to occur upon extension of credit at the discretion of the secured creditor. In response, it was said that paragraph 49 was intended to distinguish between a security agreement and a promise to grant security. However, after discussion, it was agreed that paragraph 49 was not necessary and could be deleted.

29. With regard to paragraph 50, it was suggested that, as the reference to the legal justification of a transaction was confusing, it should be deleted. That suggestion was objected to as the reference to the legal justification or basis for a transaction was important in some systems. It was also suggested that the last sentence of paragraph 50 should be revised since, in complex transactions or in transactions where the security was granted by a third party, the security agreement was a separate agreement. In addition, it was suggested that paragraph 50 should also refer to the fact that having a description of the encumbered assets in the security agreement minimized the risk of disputes over what was covered and the risk of manipulation after default.

30. As to paragraph 51, it was suggested that it should specify that both natural and legal persons could be parties to a security agreement (a matter that was said to be implicit in the reference to "person" in the definition of "debtor" and "secured creditor" in part B of chapter I). It was also suggested that the draft guide should

address the question whether enterprise mortgages or similar types of security rights could be granted by natural persons. In that connection, reference was made to the EBRD Model Law on Secured Transactions that allowed enterprise mortgages to be given only by enterprises.

31. With regard to paragraph 52, it was stated that the description of the encumbered assets should also be included in the minimum contents of the security agreement. It was also suggested that the date of the agreement should be added to the minimum contents.

32. As to paragraphs 54 to 58 and the issue of form, differing views were expressed. One view was that written form should not be required for the security agreement to be effective. It was stated that a form requirement would negatively affect a number of transactions that were concluded orally (e.g. sales with retention of title arrangements). It was also observed that, in some systems that had no form requirement even for real estate transactions, it would be very difficult to introduce such a requirement for movable assets.

33. However, the prevailing view was that a security agreement should be in writing. It was stated that written form provided certainty, which was said to be crucial where third parties were affected, and precluded post-default manipulation. It was also observed that transactions would not be negatively affected by requiring a simple writing that would not need to be signed by both parties and could include a data message (i.e. “information generated, sent, received or stored by electronic, optical or similar means, including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy”; see article 2 (a) of UNCITRAL Model Law on Electronic Commerce).

34. A suggestion was made that the recommendation could be that written form would be desirable but the matter would be left to the legislator or to the parties.

E. Proprietary requirements (paras. 61-70)

35. With regard to paragraph 61, it was suggested that it should be specified that ownership included a limited proprietary right. The Working Group recalled its decision to defer discussion of the issue whether the asset or title to it was the object of the security right until it had an opportunity to consider paragraph 61 (see A/CN.9/532, para. 100). While the Working Group recognized that there were two theories on that issue, it agreed that paragraph 61 did not need to be revised. As to paragraph 62, it was suggested that, in the absence of concrete examples, the problem that it addressed was difficult to understand.

36. With regard to paragraphs 66 to 70, it was stated that, as they addressed matters dealt with elsewhere in the draft guide (e.g. the chapters on Publicity and Priority), they might not be necessary. It was also observed that, if those paragraphs were intended to be descriptive of various approaches, they should not be cast as recommendations (as was implicit in paragraph 75).

F. Summary and recommendations (paras. 71-75)

37. There was sufficient support in the Working Group for paragraph 71. With regard to the note after paragraph 71, it was suggested that exceptions to the recommendations in paragraph 71 should be formulated to address types of secured obligation (see A/CN.9/WG.VI/WP.6/Add.3, paras. 5 and 6), types of asset (see A/CN.9/WG.VI/WP.6/Add.3, paras. 17 and 18) or types of security (see A/CN.9/WG.VI/WP.6/Add.3, para. 27) that might be subject to special, national or international, regimes. Reference was made to the Inter-American Model Law on Secured Transactions that introduced exceptions to the notion of all-asset security. Reference was also made to conventions such as the Cape Town Convention on International Interests in Mobile Equipment, since in some countries a later domestic law could supersede a convention.

38. However, it was suggested that a distinction should be drawn between types of asset, obligation or security that were subject to special laws other than general secured transactions law (which should be excluded from the scope of the draft guide altogether) and types of asset, obligation or security that were subject to secured transactions laws but involved registration in special registries (which should be included in the scope of the draft guide but excluded from the type of registration foreseen in the draft guide).

39. With regard to paragraph 72, it was suggested that it should be revised to refer to “proceeds”, rather than “readily identifiable proceeds”. It was also suggested that it should be made clear that the notion of “proceeds” included whatever was received with respect to the encumbered assets. In addition, it was suggested that recommendations should be formulated with respect to the issues addressed in the note to paragraph 72.

40. As to paragraph 73, it was suggested that it should be revised to reflect the views expressed in favour and against written form. It was also suggested that reference should be made to the definition of data message in article 2 of the UNCITRAL Model Law on Electronic Commerce. In that connection, it was stated that there was no reason why the written form requirement could not be satisfied by a data message, including an electronic record, as long as it could be retrieved and read, and showed that the grantor intended to grant a security right. In response to a question, it was observed that it did not matter who was the originator of the data message.

41. Support was expressed for the idea that the security agreement should identify the parties and reasonably describe the encumbered assets and the secured obligations. While the view was expressed that a specific description of the encumbered assets should be required, the prevailing view was that a generic description should be sufficient.

42. There was sufficient support in the Working Group for the recommendation in paragraph 74. It was also agreed that the recommendation in paragraph 75 should be revised to provide that an agreement was sufficient for the creation of a non-possessory security right, while acts of publicity would be relevant to the effectiveness of a security right as against third parties.

43. It was suggested that a recommendation should also be prepared for security in all assets of a debtor (an enterprise mortgage or floating charge type of right). It

was also suggested that a recommendation should also be made for fixtures and accessions.

44. After discussion, the Working Group requested the Secretariat to revise chapter IV taking into account the views expressed and the suggestions made.

Chapter IX. Insolvency (A/CN.9/WG.VI/WP.9/Add.6)

45. In view of the fact that insolvency law experts from Working Group V (Insolvency Law) were present, the Working Group went on to consider Chapter IX on Insolvency.

A. Introduction (paras. 1-4)

46. A couple of suggestions were made with regard to paragraph 1. One suggestion was that, as the issues briefly addressed in Chapter IX were addressed at some length in the draft guide on Insolvency Law, the penultimate sentence in paragraph 1, addressing the need to refer to the draft guide on Insolvency Law for details, should be strengthened. Another suggestion was that, in the second sentence, reference should be made to policies reflected in the draft guide on Insolvency Law, without giving arbitrary and possible misleading examples of such policies.

B. Security rights in insolvency proceedings (paras. 5-6)

47. It was suggested that the examples given in the last sentence of paragraph 6 should be deleted, since they might inadvertently give the impression that expedited reorganization proceedings dealt only with certain types of debt.

C. The inclusion of encumbered assets in the insolvency estate (paras. 7-19)

48. The Working Group agreed that encumbered assets should be part of the estate. As to whether assets subject to a retention or transfer of title should be part of the estate, differing views were expressed.

49. One view was that such assets should be treated in the same way as encumbered assets. It was stated that giving the seller with a retention of title special and superior rights, unrelated to price and quality, would distort competition with other extenders of credit and thus have a negative impact on the price of goods and services, as well as to the availability and the cost of credit. In addition, it was observed that, even if the matter was to be dealt with as one relating to the continuation or rejection of the sales contract by the insolvency representative, the assets would not be turned over to the seller before the expiry of the 30- or 60-day period within which the insolvency representative would have to make a decision. Moreover, it was said that, in the case of reorganization, or in the case of liquidation of a business as a going concern, assets subject to a retention of title would be treated in the same way as all other assets necessary for the success of the reorganization or of the liquidation of a business as a going concern. Moreover, it was pointed out that the draft guide should make clear recommendations aimed at assisting countries without modern secured transactions in obtaining the benefit of

increased access to low-cost credit rather than focusing on historical developments in certain countries which, in any case, with regard to retention of title, differed widely.

50. Another view was that assets subject to retention or transfer of title should not be part of the estate. It was stated that the seller or transferee of assets were not creditors and assets sold or transferred in a legitimate way by the debtor to another person should not be subject to the estate. Yet another view was that only assets subject to retention of title should not be part of the estate, since transfers of title for security purposes were assimilated to normal security rights in the case of insolvency, even in countries that otherwise treated them as title devices. It was observed that such a privileged treatment given to supplier credit resulted in cost-efficiencies, since supplier credit was readily available at lower cost than bank credit, and counter-balanced the dominant position of the financing institutions in the credit markets. In addition, it was said that preference given to supplier-credit was a policy decision dictated by the need to support supply markets of goods and services. For those reasons, it was suggested that retention of title should be given priority as of the time it was granted (even if it was subject to registration; "super-priority").

51. Yet another view was that the legal characterization of retention or transfer of title as security or not did not matter in insolvency as long as the assets subject to a retention or transfer of title or the debtor's rights in relation to those assets were part of the estate. It was stated that the real issue was not the legal characterization but the economic consequences of treating retention of title for purposes of publicity and insolvency as a security device or not. In response, it was stated, however, that, legal characterization did matter since, if retention of title was assimilated to a security right and assets subject to retention of title were part of the estate, the insolvency representative could keep them without having to pay the outstanding price even though it had not rejected the contract. Only if retention of title was treated as a title device, assets subject to it would be outside the estate, and, as a result, the insolvency representative would be obliged to pay the outstanding balance of the price, before any payment to other secured creditors, in order to keep the assets in the estate.

52. The Working Group noted that a broad definition of "assets" was to be considered by Working Group V (Insolvency Law) ("property, rights and interests of the debtor, including rights and interests in property whether or not in the possession of the debtor, tangible or intangible, movable or immovable, including the debtor's interests in assets subject to a security right or in third party-owned assets"). As a result, the following suggestions were made: the second sentence of paragraph 10 should be revised to reflect that all assets or rights of the debtor in relation to the assets were part of the estate, irrespective of the legal characterization of the underlying transaction; paragraph 11 should provide that transfers of assets by the debtor to the creditor would be subject to avoidance actions; paragraph 12 should provide that, if retention of title was assimilated to a security right, assets subject to retention of title arrangements would be part of the estate; paragraph 17 should provide that proceeds of encumbered assets would be part of the estate, subject to the security right, and that after-acquired assets would not be subject to the security right, unless they constituted proceeds of the encumbered assets.

53. In response to a question, it was noted that the proposed definition of "assets" did not constitute a change in the position taken in the draft guide on Insolvency Law that, while third-party assets were not part of the insolvency estate, the debtor's interests in such assets were. The Working Group agreed that any redrafting of that section should be consistent with that policy decision.

54. In the discussion, a number of suggestions were made. One suggestion was that paragraph 7 should be revised to clearly provide that encumbered assets were part of the estate. It was also suggested that, in paragraph 7, examples should be given of situations in which assets of the third-party grantor could be in the possession of the debtor. Another suggestion was that, in paragraph 10, reference should be made not only to contractual but also to proprietary rights of the debtor in relation to the encumbered assets. Yet another suggestion was that in paragraph 11, the reference to "payment or other performance by the debtor" should be substituted for the reference to "price". Yet another suggestion was that paragraphs 14 and 15 should be supplemented with reasons justifying one or the other approach to the question about the surplus remaining after payment of the seller. Yet another suggestion was that the issue of who bears the risk of any shortfalls should also be discussed. Yet another suggestion was that paragraph 16 should be revised to provide that the value of the assets might need to be determined at various times in an insolvency proceeding, depending on the purpose of the evaluation (e.g. the secured creditor may seek relief from stay because the value of the security right exceeds the value of the asset).

55. After discussion, the Secretariat was requested to revise the section so as to address the views expressed and the suggestions made, aligning the section with the relevant sections of the draft guide on Insolvency Law.

D. Limitations on the enforcement of security rights (paras. 20-27)

56. The Working Group noted that, under the approach taken in the draft guide on Insolvency Law, the stay applied to all creditors, including secured creditors, and to owners of assets in which the debtor had an interest (e.g. retention of title holders). It was suggested that the third sentence of paragraph 22 should be revised to reflect that approach. It was also suggested that paragraph 27 should be aligned with the relevant recommendations of the draft guide on Insolvency Law (35)(b), relief from measures applicable on commencement, and (43), burdensome assets). In addition, it was observed that the delay in disposing of the assets by the insolvency administrator, mentioned in the second sentence of paragraph 25, was not among the reasons for relief from the stay set forth in recommendation (35)(b).

E. Participation of secured creditors in insolvency proceedings (paras. 28-29)

57. It was noted that the draft guide on Insolvency Law provided secured creditors with a right to fully participate in the insolvency proceedings. It was, therefore, suggested that, once that point was made, a cross reference could be included to the relevant section of the draft guide on Insolvency Law and the remaining text in paragraphs 28 and 29 could be deleted. While it was agreed that paragraph 29, reflecting notions that were generally accepted in current law, could be deleted, a question was raised as to the appropriateness of deleting paragraph 28

which introduced some ideas about participation of secured creditors in creditor committees. In response, it was observed that, under the current approach followed in the draft guide on Insolvency Law, secured creditors would participate in secured creditor committees. It was pointed out that some reference to that matter could usefully be made in the new text that would replace paragraphs 28 and 29.

58. It was also suggested that the general statement about full participation of secured creditors in insolvency proceedings could be usefully supplemented by the statement that whether the secured creditor would participate as secured or unsecured creditor would depend on whether the secured obligation exceeded the value of the encumbered assets or not.

F. The effectiveness of security rights and avoidance actions (paras. 30-32)

59. The Working Group noted that avoidance of secured transactions in insolvency proceedings was discussed at length in the draft guide on Insolvency Law and agreed that paragraphs 30 to 32 should include a cross reference to and be consistent with the relevant section of that draft guide.

60. It was stated that the failure of a creditor to take the steps necessary to make a security right effective against third parties (described in the draft guide on Insolvency Law with the term "perfection") was a ground for avoiding the secured transaction that should be addressed in the draft guide. It was noted that the draft guide addressed that matter in the chapters on Publicity and Priority.

61. The concern was expressed that the reference to "transfer" in paragraph 31 might not be sufficiently clear. In order to address that concern, the suggestion was made that reference could be made to notions used in the draft guide on Insolvency Law, such as creation or "perfection" of a security right in the suspect period. An alternative suggestion was to simply refer to "secured transactions".

62. In the discussion, the suggestion was made that the section might address situations where a security right was granted by a company to another company in the same group. The suggestion was also made that paragraphs 30 to 32 should emphasize the need for short suspect and prescription periods, in particular with respect to transactions that were not fraudulent but just took place in the suspect period. Noting the first matter was dealt with by law other than secured transaction law and that the second matter was addressed in the draft guide on Insolvency Law, the Working Group decided not to address them.

G. The relative priority of security rights (paras. 33-35)

63. The Working Group agreed that, as stated both in paragraph 33 and in the draft guide on Insolvency Law, insolvency law should respect the pre-commencement priority of security rights. It was also agreed that any exceptions to that principle should be limited and, if made, expressed in a transparent and predictable way.

64. As to the examples set forth in paragraph 34, differing views were expressed. One view was that the examples should be deleted, so as not to provide any possible endorsement of such privileges (or "super priorities"). The economic effect of such

privileges, it was stated, was to reduce the value available to secured creditors, thus reducing the amount of credit available and driving up the costs. It was also observed that such a result was inconsistent with the key objectives of the draft guide.

65. Another view was, while such exceptions would not be recommended, the examples should be retained. It was observed that such an approach could enhance the usefulness and the credibility of the draft guide, which could be undermined by the lack of any discussion on an issue widely discussed in expert circles and addressed even in modern insolvency legislation. The Working Group noted with interest that a similar discussion to that in paragraph 34 was contained in the draft guide on Insolvency Law (see A/CN.9/WG.V/WP.63/Add.14, para. 424). In response, it was observed that, if the examples were to be retained, the text should include a clear statement about the potentially deleterious effects of such exceptions on the availability and the cost of credit.

66. Yet another view was that the draft guide should discuss the issue, setting the advantages and disadvantages of such privileges and leaving the decision to the legislator. It was observed that by presenting the policy question, the potential approaches and their relative advantages and disadvantages, the draft guide would be more effective in achieving its objective of providing guidance to legislators and enhancing the availability of low-cost credit. In addition, it was stated that, in some countries, such exceptions might be necessary as a result of even constitutional law provisions. It was also observed that, in countries that did not allow security to be granted over the entirety of a debtor' assets, limiting the value of the security to a percentage of the debtor's assets or preserving a percentage of the debtor's assets for unsecured creditors in the case of insolvency ("ring-fencing"), was possibly the only way for those countries to accept an all-asset type of security. In that connection, in view of the Working Group's discussion of enterprise mortgages and floating charges (see paras. 16-22 above), the suggestion was made that ring-fencing could be limited to all-asset types of security (and, possibly, to involuntary creditors as a result of tort actions).

67. In the discussion, the suggestion was made that paragraph 33 could be usefully supplemented by a reference to the need for insolvency law to honour pre-commencement subordination agreements. Noting that the matter was being considered by Working Group V (Insolvency Law), the Working Group agreed that efforts of the two Working Groups on that matter should be coordinated.

68. A number of drafting suggestions were also made, including: to replace the word "amount" in the penultimate sentence of paragraph 33 with the words, "scope" or "extent"; to add, in the last sentence, the words "such as labour or tax law" after the word "forth" and to delete the rest of the current text; to add a fourth sentence to paragraph 33 to refer to the economic impact of privileges on the availability and the cost of credit; to replace in paragraph 35 the word "because" with the word "to the extent".

69. After discussion, the Secretariat was requested to revise the section taking into account the different views expressed, and providing some balance to the current text, bearing in mind the objective of the draft guide to enhance the availability of secured credit, in particular, in developing countries.

H. Post-commencement financing (paras. 36-41)

70. It was suggested that the word "solvent" might be deleted from the penultimate sentence of paragraph 41 in order to avoid an implication that it was inappropriate to extend credit to an insolvent debtor. Otherwise, the Working Group expressed satisfaction with the current drafting of the section.

I. Reorganization proceedings (paras. 42-47)

71. A number of suggestions were made. One suggestion was that paragraph 44 should be deleted as it was inconsistent with the position taken by Working Group V (Insolvency Law) that secured creditors should participate in insolvency proceedings. Another suggestion was that the first sentence of paragraph 45 should be revised to refer to what happened if a secured creditor did not consent to a reorganization plan. Yet another suggestion was that, at the end of paragraph 46, language along the following lines should be added: "It may also be appropriate to provide the secured creditor with terms relating to the secured obligation that are consistent with those prevailing in the open market."

J. Expedited reorganization proceedings (paras. 48-51)

72. The Working Group agreed that the section should be aligned with the relevant discussion in the draft guide on Insolvency Law, one of the main features of which was that expedited reorganization proceedings were formal proceedings.

K. Summary and recommendations (paras. 52-59)

73. It was agreed that paragraph 52 should be revised to clarify that: where retention of title was treated as a security right, assets subject to it were part of the insolvency estate; where retention of title was treated as a non-security device, assets subject to it were not part of the estate; and that assets relating to a transfer of title for security purposes were part of the estate, since such a transfer was assimilated to a security device. It was agreed that the status of retention of title in and outside insolvency had not been settled and remained open. In addition, it was agreed that, consistent with the draft guide on Insolvency Law, paragraph 54 should refer to the principle of "full" participation of secured creditors in insolvency proceedings. Moreover, it was agreed that, to provide necessary flexibility to parties seeking to formulate a reorganization plan, the phrase "unless the secured creditor otherwise agrees" should be added at the beginning of the second sentence of paragraph 58. It was also agreed that some amendment of paragraph 59 was necessary given the suggestions to revise paragraphs 48 to 51, and that a redrafted provision might be based on the language of paragraph 51 slightly amended. The Working Group expressed satisfaction with the current drafting of paragraphs 53 and 55 to 57.

74. At the close of its deliberations on chapter IX, the Working Group requested the Secretariat to prepare a revised version of the chapter, taking into account the views expressed and the suggestions made.

L. Relationship between the two guides

75. The Working Group went on to consider the issue of the relationship between the draft guide and the draft guide on Insolvency Law. At the outset, it was agreed that the two guides should be consistent with each other. As to how that objective could be best achieved, differing views were expressed.

76. One view was that the chapter on Insolvency should provide a full discussion of the issues, replete of information on the possible approaches and their relative advantages and disadvantages, with examples, where necessary to illustrate a point, and firm recommendations even where those issues were addressed at length in the draft guide on Insolvency Law. It was stated that the chapter was a unique text, perhaps the most important chapter in the draft guide, and might be read in isolation from the draft guide on Insolvency Law. It was also observed that the chapter should be capable of standing alone to provide effective guidance in particular in those countries where the authorities responsible for reform in secured transactions law and in insolvency law were not the same. It was also observed that the draft guide was the place for the importance of the availability of secured credit to be emphasized, which was a point that the draft guide on Insolvency Law could not make with the same emphasis.

77. Another view was that the chapter on Insolvency should be kept as short as possible. It was observed that clarity was not affected by a shorter text, as long as appropriate reference was made to relevant parts of the draft guide on Insolvency Law. It was also pointed out that a shorter text was in the interest of avoiding divergences or, at best, repetitious advice in the two guides. In addition, it was said that expanding the chapter on Insolvency, in particular on issues discussed at length in the draft guide on Insolvency Law, might inadvertently result in overemphasizing the position of the secured creditors and detract from the overall objective for a balanced and workable approach that would offer comprehensive and consistent advice to States.

78. After discussion, it was agreed that the chapter on Insolvency could contain a full discussion of the relevant issues as long as that discussion was consistent with the discussion in the draft guide on Insolvency Law. It was also agreed that the chapter should emphasize the importance of secured credit and that the guides should be read together.

M. Coordination with Working Group V (Insolvency Law)

79. The Working Group next turned to the issue of coordination with Working Group V (Insolvency Law). It was noted that Working Group V was expected to complete its work at its next session (New York, 22-26 March 2004) and to submit the draft guide on Insolvency Law to the Commission at its thirty-seventh session (New York, 14 June-2 July 2004) (see para.121 below).

80. In view of the urgency and the importance of coordination, the Working Group agreed that another joint session of the two working groups should be held. In addition, it was agreed that that joint session could be held in conjunction with the Working Group's fifth session (New York, 29 March-2 April 2004). Moreover, it was agreed that the purpose of such a joint session, which might take one and a half days (29-30 March 2004), would be to discuss any outstanding issues and, to the extent necessary, to finetune the text on the intersection of the two guides. In that

connection, it was noted that the importance of internal coordination of delegations in the two working groups could not be overemphasized.

81. As to the issues that remained pending and should be discussed, a number of suggestions were made, including: the treatment of retention of title (and, perhaps, of transfer of title, conditional sales and financial leases) and subordination agreements in insolvency; the question of super-priorities in particular with respect to security in all of a debtor's assets; the protection of the value of the security right, including the time and the manner of determining the economic value of the security right; the length of the suspect period for avoiding preferential transfer; and the length of the period by which an insolvency representative might commence avoidance actions in relation to a secured transaction.

82. As to the intersection of the two guides, it was noted that security-related issues were discussed in various places of the draft guide on Insolvency Law, including in: chapter II. Treatment of assets upon commencement (A. 2 (b), Encumbered assets; A. 2 (c), Third party owned assets; B. 3 (c), Scope of application of the stay—secured creditors; B. 6, Duration of application of the stay; B. 8, Protection of secured creditors; B. 9, Limitations on disposal of assets by the debtor; C. 2, Use or disposal of secured assets; C. 3, Third party owned assets; C. 4, Treatment of cash proceeds; D. 3 (a), (b), Priority and security for post-commencement finance; E. Treatment of contracts; and F. 3 (d), Avoidance of Security interests); chapter III. Debtor, insolvency representative and creditors (C. 2 (f), Secured creditors—participation in insolvency proceedings); chapter IV. Reorganization plan (A. 5 (b), Approval by secured creditors); chapter V. Management of proceedings (A. 2 (a), Creditors required to submit claims); chapter VI. Priorities (C. 1 (a), Security interests).

83. After discussion, the Secretariat was requested to prepare a list of issues to be discussed at the joint session, taking into account the suggestions made.

Chapter I. Introduction (A/CN.9/WG.VI/WP.6/Add.1)

A. Purpose and scope (paras. 1-13)

84. The Working Group considered the scope of the draft guide. It was agreed that, in principle, all types of assets were capable of being the object of a security right and could be included in the scope of the draft guide, unless they were specifically excluded. Examples of clear exclusions mentioned were: securities; ships and aircraft (at least, for registration and priority purposes); and assets covered by certain conventions. As a practical matter, however, it was agreed that the focus of the draft guide should be on core commercial assets, such as goods, including inventory and equipment, and trade receivables, while the viability of including in the draft guide assets, such as promissory notes, checks, letters of credit, deposit accounts and intellectual and industrial property could be examined.

85. In particular, as to intellectual and industrial property rights, interest was expressed in view of their economic importance and the fact that they were part of transactions in which security was taken over the entirety of a debtor's assets and where security was taken over equipment. At the same time, a note of caution was struck in view of the complexity of the matters involved. In any case, it was agreed that any efforts in that field of law should be undertaken in coordination with

relevant organizations, such as the World Intellectual Property Organization (WIPO).

86. In the discussion, interest was expressed in a regime that would facilitate the cross-border recognition of security rights. It was stated that the so-called "home-country rule" could be examined with a view to determining whether a solution could be found to the problem of non-recognition of security rights once the encumbered assets passed national borders. While that statement was met with interest, it was observed that financing transactions presented many complexities that could not be resolved by way of a pure conflict-of-law approach. It was also said that the question of cross-border recognition was dealt with in chapter X (Conflict of Laws), which also included more general choice of law rules.

87. As to the formulation of various paragraphs, a number of suggestions were made. One suggestion was that, in paragraph 8, the reference to immovables should be deleted to avoid an implication that the regime envisaged in the draft guide was intended to interfere with real estate law and real estate registries. Reference was made to the Working Group's earlier discussion (see para. 20 above) that the draft guide only concerned movables, though it did not prevent a State from allowing an enterprise mortgage-type of right to include immovables. Another suggestion was that paragraph 11 should be placed in square brackets, deferring a full consideration of that text until the relevant issues had been fully resolved by the Working Group. Yet another suggestion was that in paragraph 13 reference should be made to the OHADA Uniform Act organizing securities.

B. Terminology (para. 14)

Security right

88. It was agreed that the square brackets around the word "fixtures" should be deleted. It was also agreed that no explicit reference was necessary to "accessions" since accessions were covered by the reference to "movable property". It was also suggested that the reference to *in rem* rights could be substituted with more general wording referring to the *erga omnes* effects of a security right. In addition, it was suggested that the types of assets that could be the object of security could be limited to commercial assets or corporate assets. That suggestion was objected to in particular in view of the broad approach taken by the Working Group in relation to that matter (see para. 37 above).

Grantor

89. It was agreed that reference to the grantor's ownership or possession of the assets should be deleted ("its assets"). It was also agreed that the term "person" was sufficient to cover both physical and legal persons.

Tangibles

90. It was suggested that the definition of "tangibles" was tautological and should be revised.

Fixtures

91. It was suggested that reference should be made to the immovable property "to which the fixtures were attached".

Proceeds

92. It was agreed that the definition could be revised along the following lines: "Proceeds means whatever is received in respect of encumbered assets. 'Proceeds' include fruits of the encumbered assets". It was stated that, in that way, involuntary proceeds (e.g. insurance proceeds) would be covered and the same rules could apply to both proceeds and fruits. The possibility of having separate definitions for fruits and proceeds was also mentioned. It was also stated that the difference with the definition of "proceeds" in the United Nations Assignment Convention was due to the different context and the fact that the Convention covered also outright transfers.

Priority

93. It was explained that the definition of priority was different from the definition of the term in the United Nations Assignment Convention since the context in the Convention was different and the definition served a different purpose (to refer to the applicable law a number of priority-related issues).

Possessory security right

94. The suggestion to refer to "control" as a way to exercise possession in intangible assets was objected to. It was stated that the reference to possession by way of an agent was sufficient. It was also stated that, before any changes were made, the use and the meaning of the terms "possession" and "control" in the text of the draft guide should be verified.

Insolvency proceedings/insolvency representative

95. The Secretariat was requested to align the definitions of the terms "insolvency proceedings" and "insolvency administrator" with the relevant definitions in the draft guide on Insolvency Law.

New definitions

96. It was suggested that definitions should be added for the terms "purchase money", "security right", "account debtor" and "buyer in the ordinary course of business". Due to the lack of time there was no discussion on that suggestion.

C. Examples of financing practices to be covered in the guide (paras. 15-26)

97. There was general agreement in the Working Group that the examples used were both well chosen and structured. It was also agreed that the limit in number and detail aided comprehension, and for that reason, there was a general reluctance to make major alterations to the current text.

98. With regard to paragraphs 17 and 19, it was suggested that reference should be made to purchase-money financing, which should be defined, rather than to

retention of title. It was also suggested that retention of title should be assimilated to a security right. That suggestion was objected to (see para. 107 below). It was stated that, in many countries, retention of title was not treated as a security device and thus, at least for those countries, retention of title was not covered by the current definition of "security right" contained in the draft guide. In that connection, it was suggested that retention of title should be either excluded from the scope of the draft guide altogether or included and subjected to special rules.

99. As to paragraph 20, a number of suggestions were made, including: to refer to financial lease; to refer to an option (not a requirement) for the lessee to buy; to deposit accounts along the following lines: "Agrico maintains a bank account with Lender A, whose loan enabled Agrico to pay the purchase price for the wheels. Lender A takes a security right against the bank account to guarantee repayment of the loan." As to paragraph 23, it was suggested that it should be revised to refer to inventory and receivables that were acceptable as security.

Chapter II. Key objectives (A/CN.9/WG.VI/WP.6/Add.1, paras. 27-36)

100. With regard to paragraph 27, it was stated that it reflected the overall purpose of the project and should thus be further elaborated to refer to the economic impact of secured transactions law. It was stated that the draft guide should not be a comparative law treatise but should rather include analysis and recommendations that could assist in obtaining access to credit markets especially in developing countries. While it was agreed that the economic impact of one or the other approach taken in the draft guide was a major consideration, it was stated that the economic results of any law were difficult to measure, and, in any case, depended also on the relevant infrastructure, including the judicial system and enforcement mechanisms, a point that was said to be well made in paragraph 2 of the chapter.

101. As to paragraph 28, it was suggested that reference should be made to future and contingent obligations (see A/CN.9/WG.VI/WP.6/Add.3, para. 9). As to paragraph 30, it was suggested that it should be revised to clarify that mandatory law provisions should be kept to a minimum so as to leave room for party autonomy. It was also suggested that reference should be made to the fact that the draft guide would not override consumer-protection law rather than that it would include consumer-protection provisions.

102. As to the last sentence of paragraph 35, it was observed that it should be revised to clarify that a security right should be allowed to fulfil its main function of assisting the secured creditor in recovering at least part of its claim in insolvency proceedings. While there was support for that suggestion, it was pointed out that the point should be made in a manner that was consistent with the work of Working Group V (Insolvency Law) and took into account considerations relating, in particular, to reorganization.

Chapter VII. Priority (A/CN.9/WG.VI/WP.9/Add.3)

A. Introduction (paras. 1-5)

103. It was stated that the introduction sufficiently emphasized the economic importance of the concept of priority but needed also to further explain the recommended rules and to link them with the key objectives of the draft guide. It was also observed that the concept of priority should be defined in a practical way to facilitate competition among, and avoid discrimination against credit providers.

104. In addition, it was suggested that, in paragraphs 2 and 4, reference should be made to the recommendation in paragraph 89 with regard to the modification of priority by agreement. As a matter of drafting, it was suggested that the introduction should assist the reader to navigate through the chapter by including cross references to subsequent sections.

B. Priority rules (paras. 6-14)

105. With regard to the discussion about grace periods in paragraph 10, it was suggested that it should be revised to clarify that they should be considered only if filing could not take place in advance of the conclusion of the security agreement or the disbursement of funds. It was also suggested that the last example in paragraph 10 should be deleted, because, in a first-to-file rule, the time of creation was irrelevant and the example prejudged the issue of the time of effectiveness of filing addressed in chapter V (Publicity and filing).

106. As to paragraph 12, it was suggested that, until the Working Group had been able to agree on the basic rules applicable to security rights in core commercial assets, reference to the notion of control out of context was an unnecessary complication and should thus be deleted. That suggestion was objected to. As to paragraph 13, it was suggested that the reference to the notion of "perfection" should be replaced by a reference to publicity. It was also suggested that the paragraph needed to explain why possession trumped filing.

C. Alternative priority rules (paras. 15-17)

107. As to paragraph 17, one view was that it contained an unbalanced discussion of retention of title. In support of that view, it was stated that: the fact that there was no single model of retention of title did not mean that it was an ineffective device; retention of title did not inhibit competition and was not more, but rather less, costly than other similar transactions; it was said that it was not easy for developing countries in particular to establish a registration system; and that paragraph 17 was based on the unrealistic assumption of closed national markets, and ignored the difficulties of filing in the seller's country (problem of transparency) or in the buyer's country (cost for the seller). Another view, expressed briefly due to the lack of sufficient time, was that the discussion in paragraph 17 was appropriately balanced. It was stated that transparency, predictability and certainty were the criteria against which the various approaches should be tested.

D. Unsecured creditors (paras. 19-20)

108. As to paragraph 20, it was suggested that it should include a reference to the issue of setting aside a percentage of the assets of the debtor for the satisfaction of debts owed to unsecured creditors. It was observed that the advantages and disadvantages of such an approach should also be discussed. In response, it was stated that that matter was addressed in chapter IX (Insolvency) and that, therefore, a cross reference should be sufficient. It was also suggested that paragraphs 19 and 20 should be merged with the discussion of privileges and insolvency. In response, it was pointed out that paragraphs 19 and 20 were intended to make the basic point that secured creditors prevailed over unsecured creditors and that appropriate cross references were made to the logically subsequent discussion of privileges and insolvency. It was also observed that the priority of secured creditors was a key principle of the draft guide and paragraph 20 should be revised to state it in unequivocal terms.

E. Purchase money security rights (paras. 21-29)

109. The Working Group expressed satisfaction with the concept and the current description in paragraphs 21 to 29 of purchase money security rights. It was noted that purchase money security rights were security rights in all respects with the exception of any super priority with which they might be protected for policy reasons. It was also noted that such rights performed the same economic function as retention of title and conditional sales and the extent to which they should be protected was a matter of policy. It was stated that if such rights were to be given priority as of the time they were created ("super priority"), third parties should have an objective means of ascertaining their existence.

110. The Working Group agreed that such a right should be available not only to sellers but also to other creditors who provided purchase money finance (e.g. financing institutions). It was widely felt that, in countries with a retention of title system, the same result was achieved by an assignment of the seller's claim to a financing institution, which resulted in the transfer of the retention of title to the financing institution.

111. In response to a question, it was stated that, in the rare situation where a financing institution and a supplier financed the purchase of the same assets by a buyer, the legislator would have to make a policy decision as to whether they should be paid proportionately or priority should be given to the supplier.

112. As to the notice discussed in paragraph 28, it was stated that it could be a renewable one-time notice and that, in order to avoid double financing, it should be required before delivery of the goods to the debtor.

113. In the discussion, the suggestion was made that the holder of a purchase money security right should not be liable for breach of a promise made by the debtor to a third party that no security right would be granted in the assets ("negative pledge agreement"). It was stated that that idea was reflected in articles 9 (1) and 18 (3) of the United Nations Assignment Convention.

114. After discussion, the Working Group agreed that generally, but in particular with respect to that matter, the focus should be on the economic results rather than

on the techniques used to reach those results or any labels used. It was also agreed that paragraph 17 should be revised to reflect that understanding.

F. Reclamation claims (paras. 30-33)

115. It was noted that reclamation claims were mentioned in order to ensure that the priority rules, recommended in the draft Guide, would cover all possible conflict situations and thus enhance certainty as to the rights of competing claimants.

116. In response to a question, it was stated that reclamation claims were granted by law to a seller when the seller had not acquired a security right or retained title. It was also observed that their practical application was limited as they were subject to time limitations (e.g. 10 days after transfer) and were normally extinguished upon a further transfer of the relevant goods from the initial buyer to a subsequent buyer. As to the treatment of reclamation claims in insolvency proceedings, it was said that, in some systems, they could not be raised against the insolvency representative, while in other systems they could be raised in the same way security rights were. It was agreed that that was a matter for the draft Guide on Insolvency Law.

G. Buyers of encumbered assets (paras. 34-41)

117. The Secretariat was requested to align the definition of the term "inventory" with the discussion in paragraphs 34-41, which referred to the term "ordinary" rather than to "usual" course of business.

118. In response to a question, it was stated that only the buyer in the seller's ordinary course of business should be protected and not also subsequent buyers ("remote purchasers").

119. It was also suggested that paragraphs 34 to 41 should clarify that the buyer was protected if it acquired the encumbered assets in the seller's ordinary course of business or if the secured creditor or the seller retaining title had authorized sales in the ordinary course of business. It was also suggested that those paragraphs should clarify that in both situations the secured creditor retained a security right in the proceeds from the sale of the encumbered assets.

120. After discussion, the Secretariat was requested to revise paragraphs 1 to 41 of Chapter VII taking into account the views expressed and the suggestions made.

V. Future work

121. The Working Group noted that, in view of the fact that the next session of Working Group V (Insolvency Law) (New York, 22 – 26 March 2004) would be the last session devoted to the draft guide on Insolvency Law, it would be advantageous to have the next session of Working Group VI (Security Interests) (New York, 29 March – 2 April 2004) and the joint session of the two working groups precede the session of the Working Group V. It was agreed that the Secretariat should, in consultation with the chairs of the two working groups and delegates, explore the feasibility of changing the dates of the sessions of Working Group V and VI, as well as of the joint session, which could be held on 26 March 2004.

Notes

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* (A/56/17), para. 358.

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

[3] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 459.

[4] Ibid., *Fifty-sixth Session, Supplement No. 17 (*A/56/17), para. 351.

[5] Ibid., para. 357.

[6] Ibid., *Fifty-seventh Session, Supplement No. 17* (A/57/17), paras. 202-204.

[7] Ibid., *Fifty-eighth Session, Supplement No. 17* (A/58/17), paras. 215-222.