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Report of the Working Group on Security Interests on the work of its tenth session (New York, 1-5 May 2006)*

Contents

* The report of the tenth session of Working Group VI is submitted on 12 May 2006, i.e. later than the required ten weeks prior to the start of the meeting, because the tenth session of the Working Group took place from 1 to 5 May 2006.

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I. Introduction

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

II. Organization of the session

2. The Working Group, which was composed of all States members of the Commission, held its tenth session in New York from 1 to 5 May 2006. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Belgium, Benin, Brazil, Canada, China, Colombia, Czech Republic, France, Germany, Guatemala, India, Iran (Islamic Republic of), Italy, Japan, Kenya, Lithuania, Madagascar, Mexico, Poland, Republic of Korea, Russian Federation, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Uganda, United States of America and Uruguay.

3. The session was attended by observers from the following States: Dominican Republic, Guinea, Hungary, Ireland, Maldives, the Philippines and Zambia.

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

(a) *United Nations system*: International Monetary Fund, World Bank and World Intellectual Property Organization;

(b) International non-governmental organizations invited by the Commission: American Bar Association, Center for International Legal Studies, Commercial Finance Association, Forum for International Commercial Arbitration, International Chamber of Commerce, International Federation of Insolvency Practitioners, International Insolvency Institute, International Swaps & Derivatives Association, International Trademark Association, Max-Planck Institute for Foreign and Private International Law, National Law Center for Inter-American Free Trade, New York City Bar Association and European Law Students' Association.

5. The Working Group elected the following officers:

Chairman: Ms. Kathryn SABO (Canada)

Rapporteur: Ms. Margaret Kaggwa KASULE (Uganda)

6. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.24 and Addenda 1, 2 and 5 (Recommendations) and A/CN.9/WG.VI/WP.26 and Addenda 1 to 4 (Recommendations).

7. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.

3. Adoption of the agenda.

4. Preparation of legislative guide on secured transactions.

5. Other business.

6. Adoption of the report.

III. Deliberations and decisions

8. The Working Group considered recommendations on security rights in receivables, negotiable instruments, negotiable documents, rights to payment of funds credited to bank accounts, rights to drawing proceeds from independent undertakings, as well as recommendations on pre-default rights and obligations of the parties, and recommendations 88 to 111 on default and enforcement. The deliberations and decisions of the Working Group are set forth below in chapter IV. The Secretariat was requested to revise those recommendations to reflect the deliberations and decisions of the Working Group.

IV. Preparation of a legislative guide on secured transactions

A. Security rights in receivables (A/CN.9/WG.VI/WP.26)

1. Definitions

9. Subject to substituting the word “attachments” for the word “fixtures” in definition (a) (“security right”), the Working Group approved the substance of definitions (a), (d) (“secured creditor”) and (f) (“grantor”) unchanged, and decided to delete definition (n) (“claim”) (see para. 35). The Working Group also approved the substance of definitions (o) (“receivable”), (p) (“assignment”), (q) (“assignor”), (r) (“assignee”) and (s) (“subsequent assignment”) unchanged.

10. With regard to definition (t) (“account debtor”), it was agreed that the word “account” should be deleted as it was not universally understood and was inconsistent with the terminology used in the United Nations Convention on the Assignment of Receivables in International Trade (“the United Nations Assignment Convention”). As to the distinction between the debtor of the secured obligation and the debtor of the receivable, several suggestions were made, including that the terms “borrower” or “obligor” should be used for the debtor of the secured obligation. Subject to that change, the Working Group approved the substance of the definition (t).

11. With regard to definition (u) (“notification of the assignment”), it was agreed that the commentary should explain that the act of communication was also included (not just the document) and all communications were covered irrespective of whether they took place in the context of judicial or other official service of documents, or not.

12. With respect to definition (v) (“original contract”), the Working Group agreed that the definition might need to be revised to reflect the sources of non-contractual obligations (see para. 36).

13. It was also agreed that the term "writing" should be expanded to include electronic communication as stated in recommendation 11 (see A/CN.9/WG.VI/WP.21) but the issue raised regarding signature should be deferred until the substance of recommendation 12 was agreed upon by the Working Group.

2. Recommendations

Recommendations 3 (d) and (f) (parties, security rights, secured obligations and assets covered)

14. Subject to substituting the word "attachments" for the word "fixtures", the Working Group approved the substance of recommendation 3 (d). The Working Group approved the substance of recommendation 3 (f) unchanged.

Recommendation 13 (assets and obligations subject to a security right)

15. The Working Group approved the substance of recommendation 13 unchanged.

Recommendation 14 (effectiveness of a bulk assignment and an assignment of future, parts of and undivided interests in receivables)

16. Subject to deleting the word "account" from the references to "the debtor", the Working Group approved the substance of recommendation 14 unchanged.

Recommendation 15 (effectiveness of an assignment made despite an anti-assignment clause)

17. The Working Group agreed that recommendation 15 (c), limiting the scope of application of recommendation 15 to certain types of receivables, should be retained outside square brackets for the sake of consistency with the United Nations Assignment Convention. Subject to deleting the word "account" from the references to debtor, the Working Group approved the substance of recommendation 15.

Recommendation 16 (creation of a security right in a right that secures an assigned receivable, a negotiable instrument or other obligation)

18. The Working Group considered a proposal to adjust recommendation 16, dealing with the automatic creation (i.e. without a separate act of creation) of a security right in a personal or property right that secured payment of a receivable, negotiable instrument or other obligation when the obligation was an encumbered asset within the scope of the draft Guide, and to add two new recommendations. The first recommendation would deal with the automatic third-party effectiveness of the automatically created right. The second new recommendation would extend the scope of the draft Guide to include a personal or property right otherwise outside of the scope of the Guide to the limited extent that a security right in the personal or property right would be automatically created and would be automatically effective against third parties.

19. Language along the following lines was proposed for recommendation 16:

> "The law should provide that upon creation of a security right in a receivable, a negotiable instrument, or any other obligation covered as an encumbered asset by this Guide, a security right is automatically created, without further action by either the grantor or the secured creditor, in any personal or property

right that secures payment or performance of that receivable, negotiable instrument, or other obligation. If the personal or property right is an independent undertaking, the law should not provide that a security right in the right to draw under the independent undertaking is automatically created but should provide that a security right in the right to drawing proceeds from the independent undertaking is automatically created. This recommendation does not apply to a right in an immovable that under applicable law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure."

20. In addition, language along the following lines was proposed for a new recommendation on third-party effectiveness:

"The law should provide that upon a security right in a receivable, a negotiable instrument, or any other obligation covered as an encumbered asset by this Guide becoming effective against third parties, a security right is automatically effective against third parties, without further action by either the grantor or the secured creditor, in any personal or property right that secures payment or performance of that receivable, negotiable instrument, or other obligation. If the personal or property right is an independent undertaking, the law should not provide that a security right in the right to draw under the independent undertaking is automatically effective against third parties but should provide that a security right in the right to drawing proceeds from the independent undertaking is automatically effective against third parties. This recommendation does not apply to a right in an immovable that under applicable law is transferable separately from a receivable, negotiable instrument or other obligation that it may secure."

21. Furthermore, to align the first two recommendations with recommendation 4 in A/CN.9/WG.VI/WP.21 addressing the scope of the Guide, language along the following lines was proposed for inclusion in recommendation 4:

"Except to the limited extent provided in recommendations 16 and [...] relating to a personal or property right that secures a receivable, negotiable instrument or other obligation that is within the scope of the Guide, the law should not apply to … ."

22. It was agreed that automatic creation and automatic third-party effectiveness of a security right securing a receivable, negotiable instrument or other obligation would dispense with unnecessary formalities and facilitate the enhancement of the value of a receivable, negotiable instrument or other obligation as an asset on the basis of which credit might be raised and thus have a beneficial effect on the availability and the cost of credit. It was also agreed that that result should not be achieved at the expense of third-party rights, priority or enforcement.

23. However, while there was agreement as to the economic result to be achieved, diverging views were expressed as to how that result might be achieved. One view was that the secured creditor acquired a security right in the security right in a receivable, negotiable instrument. Another view was that the secured creditor would be substituted in the rights of the grantor of the security right in the receivable, negotiable instrument or other obligation. After discussion, it was agreed that the conceptual analysis or method by which the above-mentioned practical result (automatic creation and automatic third-party effectiveness) would be achieved was

not so important as long as that result was achieved and, therefore, neutral terminology should be used that would be suitable for the various legal systems.

24. With respect to independent undertakings in particular, it was agreed that the automatic creation and third-party effectiveness of a security right in a right to drawing proceeds from an independent undertaking should not affect the right to draw under the independent undertaking or the rights and obligations of the guarantor/issuer. With respect to mortgages, it was agreed that the automatic creation and third-party effectiveness of a security right in a mortgage (or the transfer of mortgage rights) should not affect third-party rights, priority or enforcement. The example was given of the securitization of receivables secured by mortgages, in which, under the proposed recommendations, the secured creditor or transferee would register in the immovable property registry only if there was default on a receivable and wanted to enforce the mortgage that secured payment of the receivable. In that connection, a note of caution was struck to the effect that the commentary should explain that implementation of those recommendations might differ from country to country depending on the general legislation, for example, on securitization of receivables secured by mortgages.

25. After discussion, the Working Group requested the Secretariat to revise recommendation 16 as proposed and to add the two new recommendations proposed. It was also agreed that recommendation 16 should also cover outright assignments of receivables and should include language along the lines of article 10 (2) to (6) of the United Nations Assignment Convention. With respect to the provision that would deal with form requirements, it was agreed that if the security right related to assets within the scope of the draft Guide, reference should be made to the form requirements of the draft Guide, while, if the relevant assets were not covered in the draft Guide, form requirements would be subject to the law governing rights in such assets to the extent that the law did not impair automatic creation and third-party effectiveness.

Recommendations 16 bis to quinquiens (pre-default rights and obligations of the assignor and assignee)

26. Subject to the deletion of recommendation 16 bis (c), dealing with international usages that were implicitly made applicable between the parties, which was not thought to be suitable for a domestic regime, the Working Group approved the substance of recommendations 16 bis to quinquiens.

Recommendations 17 to 23 (rights and obligations of the account debtor and the assignee)

27. Subject to deleting the word “account” from the references to “the debtor”, the Working Group approved the substance of recommendations 17 to 23. The Working Group also agreed that in recommendation 17 (b)(ii) the reference to “State” should be retained (rather than “place”) of payment in order to provide flexibility with regard to a change in the place of payment within a jurisdiction as a result of an assignment.

Recommendation 37 (third-party effectiveness of a security right in receivables)

28. The Working Group agreed to delete recommendation 37 as its substance was already covered by the general rules of the draft Guide on third-party effectiveness (for the addition of another recommendation, see para. 21).

Recommendation 88 (application of this chapter to outright transfers of receivables)

29. It was agreed that recommendation 88 should be revised to clarify that, with the exception of certain rights, obligations and remedies (e.g. the obligation of the secured creditor to account to the assignor for a surplus or the liability for a deficiency), the rights, obligations and remedies provided for in the chapter on enforcement should be available to an assignee in an outright assignment.

30. In the discussion, the suggestion was made that the qualifications included in recommendation 88 (A/CN.9/WG.VI/WP.26) with respect to outright transfers of receivables without recourse to the transferor might need to be included in the insolvency chapter. While interest was expressed in that suggestion, it was agreed that a decision would require a careful consideration of the recommendations in the insolvency chapter. After discussion, the Working Group requested the Secretariat to study the matter and prepare a note for consideration by the Working Group at a future session.

Recommendations 102 and 103 (collection of receivables)

31. The Working Group approved the substance of recommendations 102 and 103 unchanged.

Recommendations 137 and 137 bis (law applicable to security rights in intangible property)

32. There was general support for the rule reflected in the first sentence of recommendation 137. As to the second sentence, it was suggested that it be deleted since: (i) the first sentence was sufficient to indicate the general rule, (ii) the commentary could explain that there were exceptions to the general rule (such as, for example, with regard to intellectual property rights as to which the principle of territoriality was applicable) and (iii) in any case, it would be inconsistent with the approach taken in the draft Guide, which did not include special rules for security rights in intellectual property rights, to establish such rules in the context of the chapter on conflict of laws. That suggestion was objected to. It was stated that the fact that the draft Guide did not include special substantive-law rules with regard to security rights in intellectual property rights did not mean that it should not include any conflict-of-laws rules in that regard. After discussion, the Working Group approved the substance of the first sentence of recommendation 137 and agreed to retain the second sentence within square brackets for consideration of the law applicable to security rights in intellectual property rights at a later stage.

33. After discussion, the Working Group approved the substance of recommendation 137 bis unchanged.

Recommendations 146 (law applicable to the obligations of the grantor and the secured creditor) and 147 (law applicable to the rights and obligations of the account debtor, etc.)

34. Subject to deleting the word "account" from the references to "the debtor" in recommendation 147, the Working Group approved the substance of recommendations 146 and 147.

Rights to performance of non-monetary obligations ("claims")

35. The Working Group considered the question whether the recommendations on receivables should apply to rights to performance of non-monetary obligations. It was generally agreed that the recommendations on receivables could apply to contractual rights to non-monetary performance but not to all rights to performance. It was thus agreed that definition (n) ("claim") was overly broad and should be deleted. It was also agreed that some special rules might be required to preserve the rights of obligors of intangibles, such as contractual non-monetary obligations.

Non-contractual receivables

36. It was agreed that the recommendations on receivables should apply to contractual and non-contractual receivables. It was also agreed that statutory limitations on the assignability of non-contractual receivables should not be interfered with and that certain recommendations should be adjusted to apply to non-contractual receivables (e.g. references to "the original contract" might need to be deleted or substituted with more general language to cover the sources of both contractual and non-contractual receivables, and representations of the assignor were not relevant in the context of non-contractual receivables).

Outright transfers of negotiable instruments

37. In the context of its discussion of recommendation 3 (f), which dealt with outright transfers of receivables (see para. 14), the Working Group considered whether outright transfers of negotiable instruments should also be covered in the draft Guide. Differing views were expressed. One view was that they should not be covered as they did not constitute secured transactions and there was no need to subject them to registration and to the same priority rules as those applicable to security transfers, since secured creditors could be protected by taking possession of the instrument.

38. Another view was that outright transfers of negotiable instruments should be covered since they formed part of important financing transactions (e.g. securitization and forfeiting), and, in practice, it was not always easy to distinguish an outright transfer from a security transfer and a receivable from a negotiable instrument. It was pointed out, however, that there was no practice involving the outright transfer of cheques or bills of exchange. In that connection, to distinguish a promissory note from those other instruments, reference was made to promises to pay as opposed to orders to pay. However, the use of that terminology was objected to as it was not universally understood. In addition, the exclusion of outright transfers of bills of exchange was objected to on the ground that such transfers were part of important financing transactions.

39. After discussion, it was provisionally agreed that outright transfers of negotiable instruments (with the exception of cheques) should be covered. At the same time, it was agreed that the issue should be revisited after the Working Group had completed its consideration of the recommendations on negotiable instruments and other relevant recommendations, and determined whether any special rules were necessary (see para. 50).

B. Security rights in negotiable instruments (A/CN.9/WG.VI/WP.26/Add.2)

1. Definitions

40. Subject to the substitution of the word "attachments" for the word "fixtures" in recommendation (i) ("tangibles"), the Working Group approved the substance of definitions (i) and (w) ("negotiable instrument"), noting that it had already approved definition (o) ("receivable") (see para. 9).

2. Recommendations

Recommendation 3 (d) (parties, security rights, secured obligations and assets covered)

41. The Working Group noted that it had already approved the substance of recommendation 3 (d) (see para. 14).

Creation of a security right in a negotiable instrument

42. The Working Group noted that the general recommendations were sufficient to address the creation of a security right in a negotiable instrument and that the commentary should explain that creation of a security right would not affect the rights obtained by the transfer of a negotiable instrument by endorsement under negotiable instrument law.

Recommendation 24 (creation of a security right in a right that secures a negotiable instrument)

43. In view of the fact that the revised recommendation 16 would cover security rights in rights that secured negotiable instruments, the Working Group decided that recommendation 24 should be deleted.

Rights and obligations of the obligor under a negotiable instrument

44. The Working Group approved the substance of a new recommendation that read as follows: "The law should provide that as between the secured creditor and (i) the person obligated on the negotiable instrument, or (ii) other persons claiming rights under the law governing negotiable instruments, the obligations and rights of those persons are determined by the law governing negotiable instruments." It was agreed that that recommendation should be placed in a new chapter dealing with the rights and obligations of third-party obligors.

Third-party effectiveness of a security right in a negotiable instrument

45. The Working Group approved the substance of a new recommendation that read as follows: "The law should provide that, where a security right in a negotiable instrument is effective against third parties, the security right continues to be effective against third parties for a short period of [to be specified] days after the negotiable instrument has been relinquished to the grantor for the purpose of presentation, collection, enforcement, renewal". It was understood that by returning the encumbered negotiable instrument to the grantor the secured creditor would be exposed, for good reasons, to the risk of losing its security only for a short period of time and only if it had not registered a notice about its security right in the general security rights registry.

46. Accordingly, the Working Group approved the substance of that recommendation but agreed that the recommendation should be limited to situations in which security rights were made effective against third parties "by a method other than registration" or "by dispossession".

Recommendation 74 (priority of a security right in a negotiable instrument)

47. Subject to clarification that paragraphs (a) and (b) referred to the secured creditor, or the buyer or other transferee, the Working Group approved the substance of recommendation 74.

Recommendations 104 and 105 (enforcement of a security right in a negotiable instrument)

48. It was agreed that the secured creditor should have a right to enforce its security right in the negotiable instrument before default only with the consent of the grantor. It was stated that that rule should apply only if parties had not addressed the matter in the security agreement. It was also observed that a different approach would upset legitimate expectations of third-party creditors of the grantor. However, at the same time, it was agreed that, recommendation 104 should not affect any right the secured creditor might have under negotiable instrument law to collect the instrument upon maturity before default even without the consent of the grantor. It was also agreed that recommendation 104 should make it clear that the enforcement rights of the secured creditor were subject to the rights of obligors of negotiable instruments under law governing negotiable instruments. Subject to those changes, the Working Group approved the substance of recommendations 104 and 105.

Recommendations 136, 140, 146 and 147 (applicable law issues)

49. The Working Group approved the substance of recommendations 136, 140, 146 and 147 unchanged.

Outright transfers of negotiable instruments

50. Recalling its earlier discussion (see paras. 37-39), the Working Group agreed that outright transfers of negotiable instruments should not be addressed in the recommendations. It was stated that such transfers were involved in specialized markets. It was also stated that there were no financial practices that involved, for example, outright transfers of cheques. However, it was also agreed that the commentary should discuss the relevant issues for the benefit of States that might

wish to address outright transfers of negotiable instruments in their secured transactions laws. It was stated that the general recommendations on the creation, third-party effectiveness and priority of a security right in a negotiable instrument, as supplemented by the relevant asset-specific recommendations, should equally apply to outright transfers of negotiable instruments. In that connection, it was pointed out that a possible alternative third-party effectiveness rule might provide that an outright transfer could be made effective against third parties automatically upon creation. As a result, it was said, a security right that was created first would have priority over a subsequently registered right (but not over a security right that became effective against third parties by dispossession of the grantor). As to enforcement, it was observed, a different recommendation might be required to provide that the transferee of the negotiable instrument could enforce it freely without first having obtained the consent of the transferor.

C. Security rights in negotiable documents (A/CN.9/WG.VI/WP.26/Add.3)

1. Definitions

51. With respect to the definition (pp) ("possession"), it was stated that reference to the requirement for actual possession might need to be deleted, as possession of goods by the issuer of the negotiable document covering those goods might be constructive (i.e. the issuer might hold possession through another person). In response, it was noted that possession should be defined by reference to actual possession for the purposes of the draft Guide, while the nature of possession of goods by the issuer required for the issuance of a negotiable document should be left to the law governing negotiable documents.

52. Subject to the substitution of the word "attachments" for the word "fixtures" in definition (i) ("tangibles") and the deletion of references to the secured creditor in definition (pp) ("possession"), the Working Group approved the substance of definitions (i), (x) ("negotiable document") and (pp).

2. Recommendations

Recommendation 3 (d) (parties, security rights, secured obligations and assets covered)

53. The Working Group noted that it had already approved the substance of recommendation 3 (d) (see para. 14).

Recommendation 28 (creation of a security right in a negotiable document)

54. The Working Group agreed that the general rules relating to creation of a security right applied to negotiable documents as well. With respect to recommendation 28, the concern was expressed that, by requiring that the goods be in the possession of the issuer at the time the security right in the goods was created, recommendation 28 might exclude multi-modal transport documents in which the goods would be in the possession of the issuer at some point of time but would have been shipped at the time the issuer created a security right in the goods. After discussion, the Working Group approved the substance of recommendation 28

unchanged. It was agreed that, as the definition of "negotiable document" referred to the law governing negotiable documents, the issue of negotiability of multi-modal transport documents was appropriately left to that law. It was also agreed that the commentary could explain that a State might wish to address multi-modal transport documents. In addition, it was agreed that the term "issuer" could be defined in a way that would make the definition work whether a multi-modal transport document was negotiable or not.

Rights and obligations of the issuer of a negotiable document

55. The Working Group approved the substance of a new recommendation that read as follows: "The law should provide that as between the secured creditor and the issuer or other person obligated on the negotiable document, the rights and obligations of those persons are determined by the law governing negotiable documents."

Recommendation 44 (third-party effectiveness of a security right in a negotiable document)

56. The Working Group agreed that the word "only" be deleted as possession was not the only method by which a security right in a negotiable document could be made effective against third parties. It was also agreed that the words "or with respect to the goods" be deleted since, as long as the negotiable document covered the goods they would be in the possession of the issuer and thus logically could not at the same time be in the possession of the grantor. In addition, it was agreed that the commentary should discuss the notion of possession in the context of electronic negotiable documents. Subject to those changes, the Working Group approved the substance of recommendation 44.

Recommendation 44 bis (third-party effectiveness of a security right in a negotiable document)

57. The Working Group agreed recommendation 44 bis should be limited to situations in which a security right was made effective against third parties "by a method other than registration" or "by dispossession". Subject to those changes, the Working Group approved the substance of recommendation 44 bis.

Recommendations 80 and 81 (priority of security rights in negotiable documents)

58. The Working Group approved the substance of recommendations 80 and 81 unchanged.

Recommendation 109 (enforcement of a security right in a negotiable document)

59. Subject to providing that enforcement could take place before default with the consent of the grantor (rather than the issuer), the Working Group approved the substance of recommendation 109.

Recommendation 136 (law applicable to security rights in tangibles)

60. It was agreed that the creation, third-party effectiveness and priority of a security right in a negotiable document should be subject to the law of the place where the document was held. It was also agreed, however, that application of that

rule might create problems where the goods were in another State. The Working Group considered a suggestion that application of the law of the ultimate destination of the goods (see A/CN.9/WG.VI/WP.24, rec. 142) might provide a sufficient solution to that problem but was not able to reach agreement. After discussion, the Working Group requested the Secretariat to prepare a note and possibly alternative recommendations to address that problem.

Recommendation 140 (law applicable to third-party effectiveness of security rights in specified types of asset by registration)

61. It was noted that recommendation 140 referred to the law of the grantor's location only when third-party effectiveness was achieved by registration.

Recommendations 146 (law applicable to the obligations of the grantor and the secured creditor) and 147 (law applicable to the rights and obligations of the account debtor, etc.)

62. The Working Group approved the substance of recommendations 146 and 147 unchanged.

D. Security rights in rights to payment of funds credited to bank accounts (A/CN.9/WG.VI/WP.26/Add.1)

1. Definitions

63. The Working Group noted that it had already approved the substance of definition (o) ("receivable") (see para. 9). With regard to definition (cc) ("bank account"), the Working Group agreed that it should be revised to refer to the encumbered asset, namely the right to payment of funds credited to a bank account. It was also agreed that the commentary should explain that funds not credited at the time of the creation of a security right (for example interest or commissions) should also be covered. As to the meaning of the term "bank", it was agreed that it should be explained in the commentary by reference to the maintenance of accounts without going into regulatory law issues (e.g. banking licence). It was also agreed that the commentary should explain that accounts maintained by central banks or payment, clearing and settlement systems should not be covered. With respect to the definition of "control", it was agreed that control should refer to the right to payment of funds credited to a bank account (rather than to the funds) and that the third way of achieving control should be revised to focus on the secured creditor becoming the customer of the bank (i.e. the account holder). Subject to the changes mentioned above, the Working Group approved the substance of definitions (cc) and (hh).

2. Recommendations

Recommendation 3 (d) (parties, security rights, secured obligations and assets covered)

64. The Working Group noted that it had already approved the substance of recommendation 3 (d) (see para. 14).

Recommendation 26 (creation of a security right in a right to payment of funds credited to a bank account)

65. Subject to the deletion of the words "as between the secured creditor and the grantor", the Working Group approved the substance of recommendation 26.

Recommendations X and Y (rights and obligations of the depositary bank)

66. Subject to the retention of the first set of bracketed language outside square brackets and the deletion of the second set of bracketed language in recommendation X (b), the Working Group approved the substance of recommendations X and Y.

Recommendation 43 (third-party effectiveness of a security right in a right to payment of funds credited to a bank account)

67. Subject to referring to control with respect to the right to payment of funds credited to a bank account and to dealing with the issue of tracing proceeds deposited in a bank account in the context of its discussion on proceeds at a later stage, the Working Group approved the substance of recommendation 43.

Recommendations 76-78 (priority of a security right in a right to payment of funds credited to a bank account)

68. Differing views were expressed as to whether a depositary bank's security right should have priority even over a security right made effective against third parties by a prior control agreement with the depositary bank, as provided in the second sentence of recommendation 76. One view was that a depositary bank should not have priority over a secured creditor with whom it had concluded a control agreement. It was stated that the control agreement should be respected. In addition, it was observed that, if the bank wanted to have priority, it would provide so in the control agreement. Moreover, it was said that that way would be simpler and more transparent than expecting the secured creditor to later seek to obtain a subordination agreement with the bank. It was also stated that the bank's rights of set-off would not necessarily justify the super-priority of the bank because whether the bank had set-off rights would be subject to other law.

69. However, the prevailing view was that the bank should have priority even over a creditor with whom it had entered into a control agreement. It was stated that otherwise the bank would not enter into control agreements at all, which would limit the amount of credit available from creditors other than the bank (or would increase its cost), or would enter into control agreements but would limit the amount of credit it would make available to its customers (or would increase its cost). In addition, it was observed that the fact that a secured creditor with control would not have priority over the rights of the depositary bank did not render the control agreement useless, since it could still protect the secured creditor as against other competing claimants (e.g. the administrator in the insolvency of the grantor). Moreover, it was pointed out that such an approach would be consistent with the rule providing that the bank's rights of set-off would have priority. Furthermore, it was said that the secured creditor with control could always seek to obtain a subordination agreement with the depositary bank.

70. In the discussion, it was noted that, according to recommendation 77, the bank's rights of set-off would have priority over the right of any secured creditor except a secured creditor who acquired control by becoming the bank's customer. After discussion, it was agreed that, for the sake of consistency, that exception should be included in recommendation 76 as well.

71. Subject to that change, the Working Group approved the substance of recommendation 76, on the understanding that the commentary would develop the other option and discuss its implications along the lines mentioned above (for another change to recommendation 76, see para. 86). In addition, subject to referring to a secured creditor acquiring control with respect to the right to payment of funds credited to a bank account by becoming the customer of the bank, the Working Group approved the substance of recommendation 77. Moreover, subject to referring to transfer of funds rather than of the right to payment of the funds and to changing collusion to knowledge that the transfer of funds violated the terms of the security agreement, the Working Group approved the substance of recommendation 78 which was intended to protect the free flow of funds in commerce.

Recommendations 106 bis, 107 and 108 (enforcement of a security right in a right to payment of funds credited to a bank account)

72. Subject to the clarification that the secured creditor would be enforcing the grantor's right to payment of the funds credited to a bank account (except where the secured creditor would acquire control by becoming the bank's customer), the Working Group approved the substance of recommendation 106 bis. Subject to clarifying that control referred to the right to payment of funds rather than to the funds themselves, the Working Group approved the substance of recommendations 107 and 108.

Recommendation 139 (law applicable to a security right in a right to payment of funds credited to a bank account)

73. Differing views were expressed with regard to the alternatives presented in recommendation 139. One view was that the law of the State, in which the branch of the bank that maintained the account was located, should apply (alternative B). It was stated that that rule in alternative B reflected the universally-recognized, dominant and characteristic link between the funds deposited into a bank account and the depositary bank maintaining that account, conformed to the expectations of all parties purporting to assert a security right in a right to payment of funds credited to a bank account, respected the need for transparency and predictability in secured transactions and, as such, furthered the objectives of the draft Guide. In addition, it was observed that the bank account involved a bilateral relationship between the customer and the bank, and raised no problem of localization of the funds credited to a bank account because of the international harmonization of the norms governing the localization and the identification of bank accounts. Moreover, it was said that the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary ("the Hague Convention") was not designed to apply to bank accounts or even to directly-held securities. Thus, the law applicable to security rights in bank accounts should be different from the law applicable to such rights in securities accounts.

74. In addition, with respect to alternative A, it was stated that it was inconsistent with established banking practice, countered transparency and predictability by creating a trap to unwary creditors, ignored the rules set by banking regulators to control banking activities and, as such, could trigger strong opposition among banks and their national regulators. In addition, it was observed that it would be very difficult for third parties to ascertain the choice of law in an account agreement because the relevant documents were usually confidential. It was further observed that application of the law of the account agreement could have serious adverse effects on banking practice, since the rights and duties of the bank or enforcement would be made subject to a law other than that of the bank's location. It was also said that party autonomy was not appropriate in the case of proprietary law issues.

75. Another view was that the rule applicable to securities under the Hague Convention (i.e. the law governing the account, subject to the depositary bank having an office in the State whose law governed the account agreement) was preferable, since bank accounts and securities accounts were very similar in many respects and their differences did not justify subjecting them to a different law. In addition, it was observed that such an approach would provide certainty and predictability, as lenders would expect to receive a copy of the account agreement (or even obtain a control agreement) before extending credit on the basis of a bank account. Moreover, it was said that alternative B would cause uncertainty, as there was no universally acceptable system to locate bank accounts. It was also mentioned that application of the law governing the bank account would not cause any changes in practice since banks already applied that rule with respect to securities accounts.

76. It was also stated that, whatever the law applicable to bank accounts might be, it would not affect the law applicable to regulatory, tax, accounting or criminal law issues, which would remain subject to the law of the bank's relevant location. It was also said that bank secrecy was not an issue since borrowers were prepared to give lenders copies of the bank account agreements so as to obtain credit on the basis of those agreements, and often lenders would obtain a control agreement with the consent of the depositary bank. In addition, it was observed that analysis based on the principle of party autonomy was not very helpful, since alternative A referred to objective connecting factors and alternative B eventually involved some degree of choice by the parties as to the location of an account.

77. Yet another view was that neither alternative A nor alternative B was satisfactory to the extent that they would result in a transfer of and a security right in a bank account being subjected to different laws. Yet another view was that reference could be made either in alternative A or in alternative B to the law governing the control agreement between the grantor, the secured creditor and the depositary bank. After discussion, the Working Group decided to retain both alternatives.

Recommendation 140 (third-party effectiveness of security rights in specified types of asset by registration)

78. Recalling its earlier discussion of recommendation 140 (see para. 61), the Working Group decided that the reference to negotiable documents should be deleted as the law of the grantor's location did not apply to security rights in negotiable documents.

E. Security rights in rights to drawing proceeds from independent undertakings (A/CN.9/WG.VI/WP.24/Add.2)

1. Definitions

79. Subject to aligning definition (y) ("independent undertaking") with article 6 (e) of the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit with respect to the confirmation of a letter of credit and definition (z) ("independent undertaking") with independent undertaking practice, while avoiding terms that might cause confusion, the Working Group approved the substance of definitions (y) and (z). As to definitions, (aa) ("guarantor/issuer") and (bb) ("nominated person"), subject to reviewing the appropriateness of referring in both to a confirmer, the Working Group approved their substance. With respect to definition (z), it was agreed that the asset subject to these recommendations was the right to proceeds and not the proceeds themselves that would take the form of money, funds in bank accounts and the like and would thus be subject to other recommendations of the draft Guide. It was also agreed that the word "drawing" should be deleted from the term "right to drawing proceeds from an independent undertaking".

80. As to definition (hh), it was agreed that it should be aligned with the definition of "control" with respect to a right to payment of funds credited to a bank account (A/CN.9/WG.VI/WP.26/Add.1, definition (hh)). Subject to that change, the Working Group approved the substance of definition (hh). While it was suggested that some discussion should be included in the commentary of the general part of the draft Guide to issues of agency, a note of caution was struck that the draft Guide should not go into other areas of law in which there were many divergences among the various legal systems.

Recommendation 3 (d) (parties, security rights, secured obligations and assets covered)

81. The Working Group noted that it had already approved the substance of recommendation 3 (d) (see para. 14).

Recommendation 16 (creation of a security right in a right that secures an assigned receivable, a negotiable instrument or other obligation)

82. The Working Group noted that it had already approved the substance of recommendation 16 (see para. 25).

Recommendation 25 (creation of a security right in a right to drawing proceeds from an independent undertaking)

83. Subject to the retention of the bracketed language outside square brackets, the Working Group approved the substance of recommendation 25.

Recommendations 25 bis, ter and quater (rights and obligations of a guarantor/issuer or nominated person)

84. With respect to recommendation 25 bis, the Working Group agreed that the reference to "the co-beneficiary" should be deleted as it was covered by the

reference to “the beneficiary” and that the reference to “prior transferor” should be placed within square brackets as it was not clear whether it was necessary. Subject to those changes, the Working Group approved the substance of recommendations 25 bis, ter and quater.

Recommendation 49 (third-party effectiveness of a security right in a right to drawing proceeds from an independent undertaking)

85. Subject to the changes agreed upon in the context of the discussion of recommendation 16 (see paras. 18-25), the Working Group approved the substance of recommendation 49.

Recommendation 62 (priority of a security right in a right to drawing proceeds from an independent undertaking)

86. It was agreed that the commentary should explain that, depending on the terms of the acknowledgment, the guarantor/issuer might be liable to an acknowledged secured creditor that would lose in a priority contest with the first acknowledged secured creditor. It was also agreed that a similar rule should be inserted in recommendation 76 (see paras. 68-71) to the effect that, among creditors that had obtained a control agreement with respect to the same bank account, priority would be determined on the basis of the time of conclusion of the control agreement, while, depending on the terms of the control agreement, the depositary bank might be liable to the secured creditor that lost the priority contest. Subject to those changes, the Working Group approved the substance of recommendations 62 and 76.

Recommendation 106 (enforcement of a security right in a right to drawing proceeds from an independent undertaking)

87. It was agreed that a security right in a right to drawing proceeds from an independent undertaking should be enforceable even before default if so agreed between the secured creditor and the grantor. Subject to that change, the Working Group approved the substance of recommendation 106.

Recommendations 138 and 138 bis (law applicable to a security right in a right to drawing proceeds from an independent undertaking)

88. Support was expressed for recommendations 138 and 138 bis. At the same time, it was widely felt that they should be explained in the commentary, possibly with the use of examples. The concern was also expressed that application of recommendation 138 bis, which would apply in more cases than recommendation 138 as independent undertakings were typically used to enhance the value of a receivable or other obligation, might be problematic to the extent that a State might not have enacted recommendations 16 and 49 providing for automatic creation and third-party effectiveness. Subject to revising recommendation 138 bis to address that concern, the Working Group approved the substance of recommendations 138 and 138 bis.

F. Chapter VII. Pre-default rights and obligations of the parties (A/CN.9/WG.VI/WP.24/Add.1)

Purpose

89. The Working Group approved the purpose section unchanged.

Recommendation 86 (party autonomy)

90. It was agreed that recommendation 86 reflected a general principle and should be moved to the general provisions of the draft Guide.

Recommendation 87 (suppletive rules)

91. It was agreed that the words "preserve and protect" should be substituted for the word "care" in paragraph (a). With respect to paragraph (d), the Working Group agreed that the discharge of the security right and the return of the encumbered asset (in the case of a possessory security right), required full payment of the secured obligation, as well as termination of all lending commitments. It was also agreed that the structure of the recommendation should be aligned with the structure of the relevant commentary (A/CN.9/WG.VI/WP.9/Add.4). After discussion, the Working Group approved the substance of recommendation 87.

G. Chapter VIII. Default and enforcement (A/CN.9/WG.VI/WP.24/Add.1)

Purpose

92. The Working Group approved the purpose section unchanged.

Recommendation 88 (application of this chapter to outright transfers of receivables)

93. The Working Group noted that it had already approved the substance of recommendation 88 (see para. 29).

Recommendations 89 (general standard of conduct) and 89 bis (liability for failure to comply with recommendations of this chapter)

94. While the view was expressed that recommendations 89 and 89 bis reflected general principles and should be placed in the general part of the draft Guide, it was agreed that they should be retained in the enforcement chapter until the Working Group had an opportunity to consider the impact of their application to other chapters of the draft Guide. With respect to the term "good faith", it was suggested that it implied a subjective text of knowledge and should be supplemented by an objective test of "fair dealing". That suggestion was objected to. It was stated that that matter was within the realm of the law of obligations rather than property law and the reference to "commercial reasonableness" was in that connection more appropriate. After discussion, the Working Group approved the substance of recommendations 89 and 89 bis unchanged.

Recommendations 90 and 91 (party autonomy)

95. The Working Group considered whether recommendation 90 should be moved to the general part of the draft Guide and agreed that the decision be deferred until all the recommendations had been carefully examined. After discussion, the Working Group approved the substance of recommendations 90 and 91 unchanged.

Recommendation 92 (rights and remedies after default)

96. The Working Group approved the substance of recommendation 92 unchanged.

Recommendations 93 (secured creditor remedies) and 94 (judicial and extrajudicial enforcement)

97. The Working Group approved the substance of recommendations 93 and 94 unchanged.

Recommendation 95 (grantor remedies)

98. The suggestion was made that the title of recommendation 95 should be revised to refer to "grantor rights". It was also suggested that the word "may" in the chapeau of recommendation 95 be replaced by stronger language along the lines "was entitled to". Subject to those changes, the Working Group approved the substance of recommendation 95.

Recommendations 96 (cumulative remedies) and 97 (other remedies)

99. The Working Group approved the substance of recommendations 96 and 97 unchanged and noted that recommendation 96, read together with recommendations 95 and 97, provided the secured creditor and the grantor with various options in the exercise of their rights and remedies. These included the right of the secured creditor to choose the asset or assets against which enforcement was sought, the right to start exercising one remedy and then change to another and the right to enforce the secured obligation or the security right or both up to full payment of the secured obligation.

Recommendation 98 (release of encumbered assets after full payment)

100. Subject to the inclusion of a reference to termination of any lending commitments, the Working Group approved the substance of recommendation 98.

Recommendation 99 (notice of intention to pursue extrajudicial enforcement)

101. After discussion, the Working Group decided to delete recommendation 99 on the understanding that a reference to a notice of intention to pursue extrajudicial enforcement would be introduced, as an alternative, to recommendation 101.

Recommendation 100 (objections to extrajudicial enforcement)

102. The Working Group approved the substance of recommendation 100 and agreed that the second sentence, in particular, should be clearly explained in the commentary.

Recommendation 101 (secured creditor's right to take possession of an encumbered asset)

103. The Working Group requested the Secretariat to prepare two alternatives, one along the lines of the first two sentences of recommendation 101 and another providing for a notice of intention to pursue extrajudicial enforcement. In addition, it was agreed that the principle of summary proceedings should be reflected in a recommendation that would apply to all the rights and remedies provided in the chapter on enforcement. Moreover, it was agreed that the commentary should discuss the notice of default, which was typically dealt with in the law of obligations. It was also suggested that the reference to use or threat of force might be expanded to cover illegal or abusive conduct in general.

Recommendations 102-109 (enforcement of security rights in receivables, negotiable instruments, proceeds of independent undertakings, funds credited to bank accounts and negotiable documents)

104. The Working Group noted that it had already approved the substance of recommendations 102 to 109 (see paras. 31, 48, 59, 72 and 87).

Recommendations 110 and 110 bis (disposition of encumbered assets)

105. After discussion, the Working Group approved the substance of recommendations 110 and 110 bis unchanged.

Recommendation 111 (advance notice with respect to extrajudicial disposition of encumbered assets)

106. Subject to positively requiring a notice of extrajudicial disposition, the Working Group approved the substance of recommendation 111.

V. Future work

107. It was widely felt that intellectual property rights (e.g. copyrights, patents or trademarks) were increasingly becoming an extremely important source of credit and should not be excluded from a modern secured transactions law. In that connection, it was stated that financing transactions with respect to equipment or inventory often included security rights in intellectual property rights as an essential and valuable component. It was also observed that significant financing transactions involving security rights in all the assets of a business grantor would typically include intellectual property rights.

108. The Working Group recalled that the recommendations of the draft Guide generally applied to security rights in intellectual property rights to the extent they were not inconsistent with intellectual property law (see A/CN.9/WG.VI/WP.26/Add.7, rec. 3 (h)). The Working Group also recalled that, as the recommendations had not been prepared with the special intellectual property law issues in mind, the draft Guide recommended that enacting States might wish to make any necessary adjustments to the recommendations to address those issues.

109. The Working Group noted that the Commission was expected to approve in principle the substance (i.e. the policy, not the formulation) of the recommendations

of the draft Guide at its upcoming thirty-ninth session (New York, 19 June to 7 July 2006). It was noted that the Commission would discuss the recommendations of the draft Guide from 19 to 23 June 2006, with the adoption of the report of that part of the Commission's session scheduled to take place on Monday, 26 June 2006 (see A/CN.9/587, para. 53).

110. The Working Group also noted that its eleventh and twelfth sessions were scheduled to take place in Vienna from 4 to 8 December 2006 and in New York from 12 to 16 February 2007 respectively, those dates being subject to approval by the Commission at its upcoming thirty-ninth session.

Notes

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), paragraph 358. For a history of the project, see A/CN.9/WG.VI/WP.22. The reports of the first to the seventh sessions of the Working Group are contained in documents A/CN.9/512, A/CN.9/531, A/CN.9/532, A/CN.9/543 and A/CN.9/549, A/CN.9/570 and A/CN.9/574. The reports of the first and the second joint sessions of Working Group V (Insolvency Law) and VI (Security Interests) are contained in documents A/CN.9/535 and A/CN.9/550. The consideration of those reports by the Commission is reflected in documents A/57/17 (paras. 202-204), A/58/17 (paras. 217-222), A/59/17 (paras. 75-78) and A/60/17 (paras. 185-187).

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