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Note by the Secretariat

Addendum

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Chapter VIII. Conflict of laws

Introduction

1. Chapter VIII of the Model Law states the rules for determining the substantive law applicable to the issues dealt with in the other chapters. These rules are generally referred to as the conflict-of-laws rules. In a State that has enacted the Model Law, a court or other authority will use the conflict-of-laws rules of chapter VIII to determine the substantive law governing issues such as the creation, effectiveness against third parties, priority and enforcement of a security right, as well as the mutual rights and obligations of the grantor and the secured creditor and the rights and obligations between third-party obligors and secured creditors. The substantive law indicated by conflict-of-laws rules may be that of the enacting State or the law of another State. It must be stressed that in the event of litigation in a State, the court or other authority will apply: (a) the substantive secured transactions law of its own legal system to characterize an issue for the purpose of selecting the appropriate conflict-of-laws rule; and (b) the conflict-of-laws rules of its own legal system to determine the law applicable to the substance of the dispute (for a more elaborate discussion of the role of conflict-of-laws rules, see Secured Transactions Guide, chap. X, paras. 1-13).

2. The application of the conflict-of-laws rules relating to security rights should not be conditional on a prior determination that the case presents an international element. Whenever a conflict-of-laws rule refers to the law of a State, that reference should not be refused on the ground of the absence of true "internationality" in the situation. Otherwise, courts might disregard a conflict-of-laws rule enacted by a State by deciding that the case is not sufficiently international on the basis of discretionary criteria that are not part of the conflict-of-laws rules of that State. In other words, if in a given situation the rule of State A points to the law of State B, it must be presumed that the legislator of State A has considered that the situation of itself is presenting an international element. In the particular circumstances where additional criteria would be a prerequisite for the application of a conflict-of-laws rule of a State, these criteria should be spelled out in the conflict-of-laws rules of that State.

3. The conflict-of-laws rule dealing with the law applicable to the mutual rights and obligations of the parties is a non-mandatory law rule (as it is not listed in art. 3, para. 1, as a mandatory law rule). This means that the parties may choose the law applicable to their contractual rights and obligations. However, the conflict-of-laws rules dealing with the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right, as well as with the rights and obligations between third-party obligors and secured creditors (or the effect of a security right on a third-party obligor), are mandatory (see art. 3, para. 1). Therefore, with respect to those matters, the parties cannot be permitted by a choice-of-law clause to avoid the substantive law provisions of the legal system to which a conflict-of-laws rule refers. This is so because security rights are property (*in rem*) rights and thus affect third parties. Allowing the parties to a security agreement to select the applicable conflict-of-laws rule would also defeat one of the main purposes of the conflict-of-laws rules, which is to identify the State whose substantive law will apply in the event of a priority dispute among competing

claimants. For example, if there is a priority dispute between secured creditor X and secured creditor Y, it would be impossible to ascertain the law applicable to the resolution of the dispute if each of X and Y had been permitted to choose in their security agreement with the grantor a different governing law for the ranking of their respective security right.

A. General rules

Article 82. Law applicable to the mutual rights and obligations of the grantor and the secured creditor

4. Article 82 is based on recommendation 216 of the Secured Transactions Guide (see chap. X, para. 61). It states that the parties to a security agreement are free to choose the law applicable to their contractual relationship. Article 82 follows the approach recommended by international texts on this matter, including the Hague Principles on Choice of Law in International Contracts (the "Hague Principles"). The question of whether there should be constraints to party autonomy with respect to the law applicable to contractual relationships is not addressed in the Model Law and is left to other conflict-of-laws rules of the enacting State. These other rules will also determine the law governing the contractual relationship of the parties in the absence of a choice of law in the security agreement; these rules will often point to the law of the State most closely connected to the security agreement. It should be noted that the rule of article 82 is confined to the contractual aspects of the security agreement. As already mentioned, matters relating to the property aspects of secured transactions (e.g. the priority of a security right) are outside the scope of freedom of contract; the parties cannot select a law other than that indicated by the conflict-of-laws rules on such matters.

Article 83. Law applicable to a security right in a tangible asset

5. Article 83 is based on recommendations 203-207 of the Secured Transactions Guide (see chap. X, paras. 28-38). It deals with the law applicable to the creation, effectiveness against third parties and priority of a security right in a tangible asset. The term "tangible asset" is defined to refer generally to all types of tangible movable asset, including money, negotiable instruments, negotiable documents and certificated non-intermediated securities (see art. 2, subpara. (jj); see also Secured Transactions Guide, chap. X, para. 26).

6. Paragraph 1 states the general rule that the law applicable to these issues is the law of the State in which the encumbered asset is located (the "*lex situs*" or the "*lex rei sitae*"). Article 89 deals with the scenario where the location of the asset changes to another State after the security right has been created. The *lex situs* rule for tangible assets is subject to five exceptions that are set out in articles 83, paragraphs 2 to 4, 95 and 97, in options B and C.

7. The first exception provides that, if a tangible asset located in a State is covered by a negotiable document in the possession of a secured creditor in another State, the priority of the security right over the asset will be determined by the law of the State in which the document is located, and not by the law of the State in which the asset covered by that document is located (see para. 2). The second exception points to the law of the State in which the grantor is located for an

asset of a type which may be ordinarily used in more than one State in the course of its normal use, that is, a "mobile asset" (see para. 3; for the meaning of "location", see art. 88; for the relevant time for determining location, see art. 89). The test is an objective one and does not refer to actual use. The most obvious example is an aircraft, which may fly from a State to many other States. The rule will apply even if a particular aircraft is actually operated only in one single State.

8. The third exception deals with a tangible asset (other than a mobile asset) in transit or to be exported (see para. 4). A security right in a tangible asset located in a State but which is in transit or destined to be moved to another State may be created and made effective against third parties under the law of the State of its ultimate destination, if the asset reaches that destination within the period of time to be specified by the enacting State. It should be noted that: (a) if the asset does not reach the intended destination in a timely fashion, the rule in paragraph 4 will not apply; and (b) the rule in paragraph 4 does not prevent a secured creditor from taking the necessary steps to create and make the security right effective against third parties under the law of the State in which the asset is actually located at the time such steps are taken. It should also be noted that paragraph 4 is a conflict-of-laws rule of the enacting State only and whether the security right will be treated as validly created and made effective against third parties in the State of the ultimate destination of the asset is a matter for the conflict-of-laws rules of that State.

9. The fourth exception is contained in options B and C in article 97, which refer to laws other than the law of the State in which the certificate is located for a security right in certificated non-intermediated securities. The fifth exception is contained in article 95, which refers to the law of the State in which the grantor is located for third-party effectiveness by registration with respect to certain types of tangible asset.

10. Another possible exception relates to assets, with respect to which a notice of a security right may be registered in a specialized title registry or noted on a title certificate. In the case of a security right in such an asset, the law applicable to the security right is the law of the State under whose authority the registry is maintained or the certificate is located (see Secured Transactions Guide, chap. X, paras. 37 and 38, as well as rec. 205; see also A/CN.9/885, para. 110, and A/CN.9/885/Add.2, para. 21).

Article 84. Law applicable to a security right in an intangible asset

11. Article 84 is based on recommendation 208 of the Secured Transactions Guide (see chap. X, paras. 39-47). It states the general conflict-of-laws rule for the creation, effectiveness against third parties and priority of a security right in an intangible asset. The applicable law is that of the State in which the grantor is located (for the meaning of "location", see art. 88; for the relevant time for determining location, see art. 89). It must be noted that receivables are covered by this rule, which is subject to several exceptions that are set out in articles 85, 94, 96 and 97.

12. The first exception relates to the priority of a security right in a receivable arising from a sale or lease of, or secured by, immovable property (see art. 85). The other exceptions relate to a security right in rights to payment of funds credited to a bank account (see art. 94), intellectual property (see art. 96, which refers both to the

lex protectionis and to the law of the State of the grantor's location) and non-intermediated securities (see art. 97).

Article 85. Law applicable to a security right in a receivable relating to immovable property

13. Article 85 is based on recommendation 209 of the Secured Transactions Guide (see chap. X, para. 54). It deals with the priority of a security right in a receivable arising from a sale or lease of, or secured by, immovable property as against the rights of competing claimants. Article 85 is an exception to the general rule of article 84 and refers that matter to the law of the State under whose authority the immovable property registry is organized. For article 85 to apply, the right of a competing claimant must be registrable (but not necessarily registered) in the relevant immovable property registry.

Article 86. Law applicable to the enforcement of a security right

14. Article 86 is based on recommendation 218 of the Secured Transactions Guide (see chap. X, paras. 64-72). Subparagraph (a) deals with the law applicable to the enforcement of a security right in a tangible asset, as defined in article 2, subparagraph (jj). It refers to the law of the State [in which enforcement takes place (*lex fori*), which in most instances would be the law of the State in which the encumbered asset would be located (for the policy reasons for this approach, see Secured Transactions Guide, chap. X, para. 66)] [in which the encumbered asset is located at the time of commencement of enforcement].

15. It should be noted that enforcement may involve several distinct acts (e.g. notice of the secured creditor's intent to obtain possession of an encumbered asset without applying to a court or other authority, disposition of an encumbered asset, and distribution of the proceeds of disposition) that may take place in different States. For example, a secured creditor may take possession of the encumbered assets in one State, dispose of them in a second State, and distribute the proceeds of disposition in a third State. A similar issue arises if a security right is created in several tangible assets that are located in different States or in a less frequent case where enforcement takes place in different States because the asset has been moved to another State after commencement of enforcement.

16. Under, subparagraph (b), the law applicable to the enforcement of a security right in an intangible asset (with the exception of a right to payment of funds credited to a bank account, intellectual property and non-intermediated securities) is the law governing priority. The main advantage of this approach is that the creation, third-party effectiveness, priority and enforcement of a security right in an intangible asset (but not the rights and obligations between the debtor of the receivable and the secured creditor; see art. 93) is referred to one and the same law (see Secured Transactions Guide, chap. X, para. 69).

Article 87. Law applicable to a security right in proceeds of an encumbered asset

17. Article 87 is based on recommendation 215 of the Secured Transactions Guide (see chap. X, paras. 55-60). The following example illustrates how article 87 operates. Assume that the original encumbered asset is inventory, which is

subsequently sold, and the purchase price is paid into a bank account. Under paragraph 1, the law applicable to the question of whether the secured creditor automatically acquires a security right in the right to payment of the funds credited to the bank account as proceeds of the original encumbered inventory will be the law of the location of the inventory. Under paragraph 2, the law applicable to the third-party effectiveness and priority of the security right in the proceeds will be the law applicable to the right to payment of funds credited to the bank account (see art. 94).

18. It should be noted that this type of bifurcated rule may lead to difficulties in cases where the law governing creation recognizes a broad-based automatic proceeds rule whereas the law governing third-party effectiveness and priority recognizes no or only a very limited automatic proceeds right. It should also be noted that this article is dealing only with the law applicable to proceeds derived from the original encumbered assets as a result of a disposition by the grantor or other event prior to enforcement, whereas article 86 deals with the law applicable to the distribution of proceeds derived from a disposition of the encumbered assets pursuant to post-default enforcement proceedings.

Article 88. Meaning of "location" of the grantor

19. Article 88 is based on recommendation 219 of the Secured Transactions Guide (see chap. X, paras. 73 and 74). It should be noted that the State in which a grantor that is a legal person has its central administration is not necessarily the State in which that legal person has its statutory seat (or registered office). If the grantor is a legal person formed under the law of State A with its statutory seat in that State but has in State B a place of business where its senior management is based, then the grantor is located in State B. As a result of this approach, for example, the creation, third-party effectiveness, priority and enforcement of a security right in a receivable is referred to a single law that is easy to determine and is most likely to be the law of the State in which the main insolvency proceeding with respect to the grantor will take place.

Article 89. Relevant time for determining location

20. Article 89 is based on recommendation 220 of the Secured Transactions Guide (see chap. X, paras. 75-78). It deals with the situation where the location of the asset or the location of the grantor changes from one State (State A) to another (State B) in circumstances where the applicable law is determined by reference to that location.

21. Paragraph 1 establishes that State B will recognize the existence of the security right if the latter was validly created under the law of State A at the time the asset or the grantor was located in State A. However, if a priority dispute arises either in State A or in State B, the substantive law of State B will be applied to determine whether the security right is effective against third parties and has priority over the rights of competing claimants. As a result, for the security right to be treated as being effective against third parties either in State A or in State B, the third-party effectiveness requirements of the law of State B must have been fulfilled. This is so even if the security right had been made effective against third parties under the law of State A at the time the asset or the grantor was located in State A. Indeed, this analysis assumes that both States are enacting States.

22. Paragraph 2 constitutes an exception to the general rules of paragraph 1. In the event of a priority dispute between two security rights that have been made effective against third parties in the State of the initial location (State A, in the example), the priority dispute will be resolved under the law of the State of the initial location.

Article 90. Exclusion of *renvoi*

23. Article 90 is based on recommendation 221 of the Secured Transactions Guide (see chap. X, para. 14). Its purpose is to reject the doctrine of *renvoi* and provide greater certainty with respect to the law applicable by avoiding the complications arising from this doctrine. Under this doctrine, the applicable law as indicated by the conflict-of-laws rules of a State (State A) includes the conflict-of-laws rules of the State whose law is the applicable law. As a result of this doctrine, if the conflict-of-laws rules of State A refer the priority of a security right in a receivable to the law of the State in which the grantor is located (the law of State B) and the conflict-of-laws rules of State B refer that issue to the law governing the receivable (which is the law of State C), then a court in State A will resolve the priority dispute using the law of State C (and not the law of State B). This result, however, would create uncertainty as to the law applicable and also run contrary to the expectations of the parties. For those reasons, article 90 prohibits *renvoi* (for an exception, see art. 98, para. 3).

Article 91. Overriding mandatory rules and public policy (*ordre public*)

24. Article 91, which is based on recommendation 222 of the Secured Transactions Guide (see chap. X, para. 79) and article 11 of the Hague Principles, states generally recognized principles of private international law.

25. To illustrate how the rules in paragraphs 1 and 3 will operate, assume that the law of the forum prohibits dealings in certain types of asset (such as an asset which is the proceeds of criminal activities or is the subject of international sanctions) and that the law of the State whose law is applicable does not contain such a prohibition. In such a case, the forum court may refuse to recognize as validly created a security right created in the asset under the foreign law that is applicable under the provisions of this chapter even though that law does not contain the same prohibition. However, to do so, the forum court must conclude that the application of the foreign law would be manifestly contrary to the public policy of the forum State (see para. 3).

26. Under paragraphs 2 and 4, the forum court (if it is allowed to do so under its law) may refuse to recognize as validly created a security right permitted to be created under the applicable law (even if the law applicable is the law of the forum), if the creation of such security right would be manifestly contrary to public policy of a State which has a close connection with the situation. For example, if a law firm is located in the forum State and under the applicable law of the forum State a security right may be created in receivables arising from legal services, but the location of the client is in a foreign State, which has strict confidentiality rules prohibiting a security right in a law firm's receivables arising from legal services, the forum court may refuse the application of the applicable law of the forum State, if it finds that its application would be manifestly contrary to the public policy of the State of the location of the client.

27. Paragraph 5 is intended to make clear that the rules in paragraphs 1-4 may also be relied upon by an arbitral tribunal, although, unlike a court, it does not operate as part of the judicial infrastructure of a specific legal system. Under paragraph 5, an arbitral tribunal may take into account the overriding mandatory provisions and policies, for example, of the place of arbitration, however identified, or of the place where enforcement of any award would be likely to take place. Paragraph 5 requires an arbitral tribunal to determine whether it is required or entitled to take into account public policy or overriding mandatory provisions of another law, having regard (in particular) to the agreement of the parties, the designated or deemed seat of the arbitration, any institutional rules applicable to the arbitration, and the potentially controlling influence of State courts applying local arbitration legislation (see commentary to article 11(5) of the Hague Principles).

28. Under paragraph 6, the forum State may not displace the provisions of the law applicable to third-party effectiveness and priority of a security right on the ground that this would offend its public policy (or that of another State), and apply its own third-party effectiveness and priority provisions or those provisions of another State. This approach is justified by the need to achieve certainty with respect to the law applicable to third-party effectiveness and priority. The same approach is followed in article 23, paragraph 2, article 30, paragraph 2, and article 31 of the Assignment Convention, as well as in article 11, paragraph 3, of the Hague Securities Convention.

Article 92. Impact of commencement of insolvency proceedings on the law applicable to a security right

29. Article 92 is based on recommendation 223 of the Secured Transactions Guide (see chap. X, paras. 80-82). Its purpose is to establish that an insolvency court in the enacting State must in principle respect the law applicable to security rights under its conflict-of-laws rules. However, nothing in article 92 restricts the application of the law of the State in which insolvency proceedings are commenced (*lex fori concursus*) to matters such as the avoidance of fraudulent or preferential transactions, the treatment of secured creditors, the ranking of claims and the distribution of proceeds in the grantor's insolvency.

B. Asset-specific rules

Article 93. Law applicable to the rights and obligations between third-party obligors and secured creditors

30. Article 93 is based on recommendation 217 of the Secured Transactions Guide (see chap. X, paras. 62 and 63) and article 29 of the Assignment Convention. Its purpose is twofold. First, the conflict-of-laws rules on the third-party effectiveness or enforcement of a security right do not apply to the effectiveness or enforcement of a security right against a debtor of a receivable, an obligor under a negotiable instrument or an issuer of a negotiable document; they are not considered "third parties" for the purposes of the rules on third-party effectiveness and priority of a security right, as they are not competing claimants. Second, the law applicable to these issues is the law governing the legal relationship between the grantor and the relevant debtor of the receivable, or the relevant obligor under the instrument or

the issuer of the document; the same law also applies to the question of whether any of the latter may invoke that their agreement with the grantor prohibits or limits the grantor's right to create a security right in the relevant receivable, instrument or document.

Article 94. Law applicable to a security right in a right to payment of funds credited to a bank account

31. Article 94 is based on recommendation 210 of the Secured Transactions Guide (see chap. X, paras. 49-51). It departs from the general conflict-of-laws rule on the law applicable to intangible assets (see art. 84). A right to payment of funds credited to a bank account is in the generic sense a receivable of the customer against the depositary institution but a different rule applies in this case for the determination of the applicable law. Two options are offered to the enacting State for the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as to the rights and obligations between the depositary institution and the secured creditor.

32. Under option A, the applicable law is that of the State of the location of the branch or office of the depositary institution with which the account is maintained. It should be noted that a branch (or office) of a depositary institution may be considered as being located in a particular jurisdiction irrespective of whether the institution offers its services through physical offices or only through an online connection accessible electronically by customers. In this regard, it should be noted that a depositary institution must generally have a physical presence or legal address in a jurisdiction in order to be allowed by the relevant regulatory authorities to carry on business in that jurisdiction.

33. Under option B, the applicable law is the law designated in the account agreement as governing the issues that are the subject of article 94 or, in the absence of a designation of a law for these issues, the law designated by the parties to the account agreement as the law governing that agreement. To be effective for conflict-of-laws purposes, a designation must refer to the law of a State in which the depositary institution is engaged in the business of maintaining bank accounts. It must be noted, however, that the State whose law is so designated may be different than the State in which the grantor's bank account is maintained.

34. If the applicable law cannot be determined as described in the preceding paragraph, option B provides for a series of rules along the lines of the default rules contained in article 5 of the Hague Securities Convention, which the enacting State may wish to insert in this article, if it decides to adopt option B of article 94.

Article 95. Law applicable to the third-party effectiveness of a security right in certain types of asset by registration

35. Article 95 is based on recommendation 211 of the Secured Transactions Guide (see chap. X, para. 34). This article is an exception to the conflict-of-laws rules on the third-party effectiveness of a security right in a negotiable instrument, negotiable document, right to payment of funds credited to a bank account or certificated non-intermediated security. Under articles 83, 94 and 97, the effectiveness against third parties of a security right in any of these assets is

governed by the law of a State which may be different from the State of the location of the grantor. However, under article 95, if the State of the location of the grantor recognizes registration of a notice as a method of third-party effectiveness for a security right in a negotiable instrument, negotiable document, right to payment of funds credited to a bank account or certificated non-intermediated security, then the law applicable to third-party effectiveness by registration is the law of the State in which the grantor is located.

Article 96. Law applicable to a security right in intellectual property

36. Article 96 is based on recommendation 248 of the Intellectual Property Supplement (see paras. 284-337). The effect of paragraph 1 is the following. If intellectual property is protected in a particular State, the law of that State will apply to the requirements to be met for the security right in that intellectual property to be considered as having been created, made effective against third parties and enjoying priority. It should be noted that a security right in intellectual property may be granted by any person that is entitled to use the related intellectual property under the relevant intellectual property law. Therefore, the grantor may be an owner, a transferee, a licensor or a licensee of the intellectual property to be encumbered.

37. Paragraph 2 provides for an alternative way to create and make effective against certain third parties a security right in intellectual property. Under paragraph 2, the secured creditor may also use for these purposes the law of the State in which the grantor is located. The principal benefit of paragraph 2 is that if the security right has been made effective against an insolvency representative of the grantor under the law of the State in which the grantor is located, an insolvency court in the enacting State will recognize the security right even if the third-party effectiveness requirements of all States in which the intellectual property is protected have not been fulfilled.

38. Paragraph 3 refers to the law of the State in which the grantor is located for enforcement issues relating to intellectual property. If enforcement involves several acts that take place in several States, this rule would still lead to the application of one and the same law because it is unlikely that the grantor's location would change between any of those acts. Moreover, in the rare case where there would be such a change, it is assumed that a court would refer to the law of the State in which the grantor is located at the time of commencement of the enforcement. It should be noted that the effectiveness of the security right against persons other than the grantor (e.g. the licensor of the intellectual property, if the grantor is a licensee) is outside the scope of this article.

Article 97. Law applicable to a security right in non-intermediated securities

39. […].

[*Note to the Commission: The Commission may wish to note that the commentary to article 97 will be prepared after the Commission has made a decision as to which of the options is to be retained or, alternatively, whether the article should include several options, and reached an agreement as to the contents of the article.*]

Article 98. Law applicable in the case of a multi-unit State

40. Article 98 is based on recommendations 224-227 of the Secured Transactions Guide (see chap. X, paras. 83-87). Its purpose is to deal with the law applicable where the State whose law is applicable has two or more territorial units. In such a case, paragraph 1 provides that a reference to the law of a multi-unit State is a reference to the law applicable in the relevant unit. For example, in a federal State, secured transactions laws may fall under the legislative authority of one of its territorial units. In such case, each unit will have its own substantive law and conflict-of-laws rules. Under paragraph 2, the relevant unit is to be determined on the basis of the location of the grantor or of the encumbered asset, or otherwise under the provisions of this chapter. It should be noted that paragraphs 1 and 2 are interpretative provisions and also apply where the forum State is the State whose law is applicable under the provisions of this chapter.

41. Where the applicable law is that of a multi-unit State, paragraph 3 provides that the conflict-of-laws rules in the relevant State or territorial unit will determine whether to apply the law of a different territorial unit in the State (see Secured Transactions Guide, chap. X, para. 85). This means that the forum court is required to examine the internal conflict-of-laws rules of the State of the location of the grantor or the encumbered asset. In this regard, the Assignment Convention allows a declaration by States as to the determination of the applicable priority rule as between various territorial units (on art. 37 of the Assignment Convention), but in this article there would be no declaration and the forum court would have to determine the applicable law under the conflict-of-laws rules of the multi-unit State.

42. To illustrate how the rule in paragraph 3 will operate, assume that the conflict-of-laws rules of this chapter refer to the law of the location of the grantor and that the location of the grantor under this chapter is in a territorial unit of a multi-unit State whose laws (including its conflict-of-laws rules) govern secured transactions. Also assume that the location of the grantor under this chapter is in unit A of that multi-unit State (unit A being the place of central administration of the grantor). If, however, the conflict-of-laws rules of unit A refer to the law of unit B as being the applicable law (e.g. because unit B also refers to the location of the grantor but defines the location of the grantor as its statutory seat instead of its place of central administration), then the forum court would have to apply the law of unit B if the statutory seat of the grantor is in unit B.

43. Paragraph 3 is indirectly an exception to the exclusion of the doctrine of *renvoi* (see art. 90) as it introduces “internal *renvoi*”. The purpose of the exception is to ensure that where the applicable law is that of a unit of a multi-unit State, a forum court outside that multi-unit State will apply the substantive law of the same unit as a forum court in that multi-unit State.

Chapter IX. Transition

Introduction

44. This chapter has three functions. First, it provides that prior law governing security rights (the “prior law”) is to be repealed (see art. 99). Second, it provides rules governing the treatment under the new secured transactions law (the “new

law") of security rights that are created while the prior law is in force but continue to be effective, perhaps for extensive periods of time, after the new law enters into force (see arts. 100-104). Third, it provides for the setting of a date on which the new law goes into effect (see art. 105). Thus, this chapter provides rules by which the law governing such security rights moves in a fair and efficient manner from the prior law to the new one (see Secured Transactions Guide, chap. XI, paras. 1-3).

Article 99. Amendment and repeal of other laws

45. The Model Law is intended as a complete system of secured transactions law, replacing in its entirety the prior law, rather than a supplement to existing law. Accordingly, the enacting State should list in paragraph 1 and thus repeal the body of laws that comprise its secured transactions law. The way in which the repeal is effectuated will depend on the form of the prior law. Where the prior law is a free-standing code or the like, that code can be repealed in its entirety. Where the prior law is derived from statutes that also address other topics, though, the enacting State must determine how to excise the rules formerly governing security rights from the rules that apply to other topics. Where part of the prior law is based on judicial opinions (as may be the case, for example, in some common law systems), the method of repeal of the prior law must be determined by the enacting State.

46. Many other bodies of law interact with secured transactions law. In some cases, provisions of those other bodies of law may be written on the assumption that prior secured transactions law is in effect. Paragraph 2 provides the enacting State an opportunity to amend those provisions so as to mesh with the new law. It should be noted that, like any other article of the Model Law, article 99 can have effects only when the new law enacting the Model Law enters into force according to article 105. Thus, the existing laws are amended or repealed only as of the date the new law enters into force (in other words, there is no time in which neither set of rules governs secured transactions).

Article 100. General applicability of this Law

47. Paragraph 1 of this article defines two terms used in this chapter. According to subparagraph 1(a), "prior law" means the law of the State (whether the enacting State or another State), whose law was applicable under the conflict-of-laws rules of the enacting State before the entry into force of the new law. As a different law may be applicable to the various security right issues (i.e. contractual rights and obligations between the grantor and the secured creditor, creation, third-party effectiveness, priority and enforcement of a security right, as well as effectiveness of the security right against a third-party obligor) prior law means the law applicable to the relevant issue.

48. According to subparagraph 1(b), "prior security right" is a right created by an agreement entered into before the entry into force of the new law, provided that the new law would treat that right as a security right. This is the case even if the agreement covers future assets (see art. 2, subpara. (n)). As a result, such a security right will be governed by the transition provisions of the Model Law.

49. Paragraph 2, which is based on recommendation 228 (second sentence) of the Secured Transactions Guide (see chap. XI, paras. 7-12), states the general rule of the applicability of the new law. It provides that, when it enters into force under

article 105, the new law enacting the Model Law will apply to all security rights within its scope, including prior security rights, except as otherwise provided in this chapter (e.g. art. 101). Much of the remainder of the chapter is devoted to describing exceptions to this general rule. Read together, the rule in paragraph 2 and the exceptions in the remainder of the chapter result in a transition period during which the new law will apply to all new transactions while some aspects of the prior law will continue to apply to some issues related to prior security rights until the expiration of the period described in article 103, subparagraph 1(b).

50. As a result of paragraph 2, prior security rights may be governed, at least in part, by the new law. Inasmuch as many secured transactions endure for several years, if the new law applied only to security rights created by agreements entered into after the effective date of the new law, the prior law would persist for a lengthy period during which lenders, borrowers, attorneys, and judges would need to apply both laws and search for competing claimants under the rules of both. This result would entail additional cost as well as delaying the economic benefits of the new law.

Article 101. Applicability of prior law to matters that are the subject of proceedings commenced before the entry into force of this Law

51. Article 101 is based on recommendation 229 of the Secured Transactions Guide (see chap. XI, paras. 13-16). It introduces an exception to the rule in article 100, paragraph 2, that the new law applies to all security rights within its scope, including prior security rights. In particular, paragraph 1 provides that, if a matter with respect to a security right is the subject of litigation or arbitral proceedings commenced before the new law enters into force, the law governing the substance of the dispute will remain the prior law. This paragraph applies to all disputes arising under the prior law, whether between the secured creditor and the grantor, the secured creditor and a competing claimant, or the secured creditor and a person liable, for example, on a receivable or negotiable instrument. It should be noted that the commencement of litigation before the new law enters into force with respect to one dispute does not preclude application of the rules of the new law to a separate dispute arising under the same security agreement.

52. Paragraph 2 provides a substantive rule about the enforcement of security rights created under prior law. Under the rule in this paragraph, if enforcement is commenced under prior law (what constitutes “enforcement” and when “enforcement” begins is a matter of prior law), the secured creditor may continue enforcement under the rules of the prior law even after the new law enters into force (what constitutes “enforcement” under the new law is addressed in chapter VII). This means that, whether any of the enforcement remedies are exercised with or without application to a court or other authority results in a clear statement that, if enforcement commenced before the new law entered into force, the secured creditor may continue under the prior law, or discontinue enforcement and commence it under the new law. Thus, even if the secured creditor enforces its security right without applying to a court or other authority, for example, by taking one of the steps necessary to obtain possession of an encumbered asset before the new law enters into force, the secured creditor may choose to have its other enforcement actions that are independent of obtaining possession (such as the disposition of the encumbered asset and the distribution of the proceeds) be governed by the prior law.

Article 102. Applicability of prior law to the creation of a prior security right

53. Article 102 is based on recommendation 230 of the Secured Transactions Guide (see chap. XI, paras. 17-19). This article contains two rules. First, paragraph 1 makes clear that prior law determines whether a security right putatively created before the new law enters into force was indeed created effectively. Second, under paragraph 2, a prior security right that was effectively created under prior law will remain effective between the parties under the new law even if the requirements for creation under the new law have not been satisfied. This rule avoids the invalidation of prior security rights and the creation of a situation in which the secured creditor would need to obtain cooperation from the grantor to take the additional steps necessary to continue the existence of the security right under the new law. Such cooperation may not be forthcoming from a grantor that has already received an extension of credit secured by the security right in the encumbered asset.

Article 103. Transitional rules for determining the third-party effectiveness of a prior security right

54. Article 103 is based on recommendation 231 of the Secured Transactions Guide (see chap. XI, paras. 20-22). Under this article, a security right created and made effective against third parties under prior law before the effective date of the new law remains effective against third parties for a period of time under the new law, even if the conditions for third-party effectiveness under the new law have not been satisfied. The period expires at the earlier of the time when the third-party effectiveness of the security right would have ceased under prior law (see subpara. 1(a)) or at the time specified in subparagraph 1(b).

55. Illustration: Under the former secured transactions law of State X, a security right in receivables could be made effective against third parties by notifying the debtor of the receivable (the “Debtor”); however, such notification would cease to be effective after one year unless the secured creditor (the “Creditor”) sent a renewal notice to the Debtor, which would extend the effectiveness of the notice for another year. When State X enacted the Model Law, it inserted “three years” as the time period in subparagraph (1)(b). On 1 July of Year 1, prior to the effective date of the new secured transactions law, the Grantor created in favour of the Creditor a security right in receivables owed to the Grantor by the Debtor, and the Creditor notified the Debtor about the security right. The effective date of the new law in State X is 1 January of Year 2. Under subparagraph (1)(a), the security right of the Creditor would cease to be effective against third parties under prior law on 1 July of Year 2. Under subparagraph (1)(b), the third-party effectiveness would cease on 1 January of Year 5. As 1 July of Year 2 (the date identified in subparagraph 1(a)) is earlier than 1 January of Year 5 (the date identified in subparagraph (1)(b)), third-party effectiveness will cease on 1 July of Year 2, unless the requirements of the new law are satisfied.

56. A security right that would cease to be effective against third-parties under the rule in paragraph 1 may continue to be effective against third parties if the secured creditor takes the appropriate steps under the new law to achieve third-party effectiveness. Most often, this result will be accomplished by registering a notice with the Registry. The secured creditor’s ability to do so is aided by paragraph 4, which provides that the prior written agreement creating the security right constitutes sufficient authorization for registration of the notice.

57. Paragraphs 2 and 3 address the continuity of third-party effectiveness of a prior security right in situations in which: (a) a security right was initially effective against third parties under the new law only by operation of paragraph 1; and (b) the requirements for third-party effectiveness under the new law were satisfied only after the new law entered into force. Paragraph 2 provides that, if the requirements for third-party effectiveness under the new law are satisfied before the expiration of the period specified in paragraph 1, the prior security right continues to be effective against third parties from the time when it was made effective against third parties under prior law and, thus, priority under the relevant rules according to which priority depends on the time of third-party effectiveness will date from that time.

58. If, however, the requirements for third-party effectiveness of the prior security right are satisfied only after the expiration of the period specified in paragraph 1, there will be a gap between the expiration of third-party effectiveness under paragraph 1 and the achievement of third-party effectiveness under the new law. In that case, paragraph 3 provides that the security right is effective against third parties only from the time it is made effective against third parties under the new law and, thus, priority under the relevant rules according to which priority depends on the time of third-party effectiveness dates only from that time.

Article 104. Application of prior law to the priority of a prior security right as against the rights of competing claimants arising under prior law

[*Note to the Commission: The Commission may wish to note that the commentary to this article has been prepared on the assumption that the Commission will decide to delete article 104, paragraph 1, because it is inconsistent with article 103*.]

59. Like article 103, article 104 deals with a situation in which the priority of a security right as against competing claimants will be determined by reference to prior law. Under article 103, the time when third-party effectiveness was achieved under prior law is utilized in some circumstances in determining priority under the priority rules in the new law. Under article 104, there are some situations in which priority under the new law is determined altogether by application of prior law.

60. In particular, under the rule stated in paragraph 1, the prior law, rather than the new law, determines the priority of a prior security right against competing claimants if that security right and the rights of all competing claimants arose before the entry into force of this Law and the "priority status" of competing claimants has not changed. Paragraph 2 provides that the priority status of a security right has changed if either of the two events has occurred. First, the priority status has changed if: (a) the prior security right was effective against third parties under the new law only because of the rule in article 103(1); and (b) third-party effectiveness ceased [because the expiration of the time period described in article 103(1) occurred before the necessary actions occurred to make the security right effective against third parties under the new law.] Second, the priority status of a security right has changed if it was not effective against third parties under the prior law at the time the new law entered into force but became effective against third parties when the new law entered into force or thereafter. The purpose of this rule is to preserve priority among completing claimants that was established under the prior law when no change has occurred other than the new law becoming effective.

Article 105. Entry into force of this Law

61. Article 105 is based on recommendation 228 of the Secured Transactions Guide (see chap. XI, paras. 4-6). It leaves it to the enacting State to determine the date when or the mechanism according to which the new law will enter into force. The enacting State may also wish to determine whether this article should be placed at the beginning or at the end of the new law.

62. In determining when the new law will enter into force, careful consideration should be given both to obtaining the economic benefits of the new law as soon as possible and to minimizing dislocations that may be caused by significant changes in secured transactions practice resulting from the new law. Inasmuch as the new law will have been chosen because it is an improvement over the prior law, the new law should come into force as soon as is practical. However, some lead time is necessary in order to, inter alia: (a) publicize the existence of the new law; (b) enable establishment of the Registry (or adaptation of an existing registry to the registry system required by the new law); and (c) enable participants in the secured transactions system, particularly present and future secured creditors, to prepare, for example, for compliance with new rules and develop new forms. For example, the new law may enter into force on a specific date or a few months after a specific date, or on the date to be specified by a decree once the Registry becomes operational.