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Possible future legislative work on security interests and related topics

Note by the Secretariat

Contents

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I. Introduction

1. At its forty-third session, in 2010, the Commission considered a note by the Secretariat entitled "Possible future work on security interests" (A/CN.9/702 and Add.1), and decided to entrust Working Group VI with the preparation of a text on registration of security rights in movable property.[1] At that session, the Commission also decided to retain on its future work programme the following topics: (a) security rights in non-intermediated securities; (b) a model law on secured transactions; and (c) a text dealing with the rights and obligations of the parties to secured transactions.[2] The Commission also requested the Secretariat to prepare a study on intellectual property licensing.[3]

2. At its forty-sixth session, in 2013, the Commission adopted the UNCITRAL Guide on the Implementation of a Security Rights Registry.[4] At that session, the Commission considered a note by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.55 and Add.1-4), and entrusted Working Group VI with the preparation of a model law on secured transactions.[5]

3. At its forty-seventh session, in 2014, the Commission considered a note by the Secretariat entitled "Draft Model Law on Secured Transactions: Security Interests in Non-Intermediated Securities" (A/CN.9/811), and agreed that the draft model law on secured transactions prepared by Working Group VI should also cover security rights in non-intermediated securities.[6]

4. At its forty-eighth session, in 2015, the Commission agreed that a draft guide to enactment of the draft model law on secured transactions should be prepared and referred that task to Working Group VI.[7] At that session, the Commission also noted that, at its forty-third session, it had placed on its future work programme the preparation of a contractual guide on secured transactions and a uniform law text on intellectual property licensing, and decided that those matters should be retained on its future work programme and considered at a future session on the basis of notes to be prepared by the Secretariat, after a colloquium or expert group meeting, to be held within existing resources.[8]

5. At its forty-ninth session, in 2016, the Commission considered notes by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/884 and Add.1-4) and "Draft Model Law on Secured Transactions: compilation of comments" (A/CN.9/886, A/CN.9/887 and Add.1), and adopted the UNCITRAL Model Law on Secured Transactions.[9] At that session, the Commission had before it a note by the Secretariat entitled "Draft Guide to Enactment of the draft Model Law on Secured Transactions" (A/CN.9/885 and Add.1-4), and agreed to give Working Group VI up to two sessions to complete its work and submit the draft Guide to Enactment to the Commission for final consideration and adoption at its fiftieth session, in 2017.[10]

6. At that session, noting its earlier decisions (see paras. 1 and 4 above), the Commission also considered its possible future work on security interests and

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[1] *Official Records of the General Assembly, Sixty-fifth Session, Supplement No. 17* (A/65/17), para. 268.
[2] Ibid.
[3] Ibid., para. 273.
[4] *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 191.
[5] Ibid., para. 194.
[6] *Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17* (A/69/17), para. 163.
[7] *Official Records of the General Assembly, Seventieth Session, Supplement No. 17* (A/70/17), para. 216.
[8] Ibid., para. 217.
[9] *Official Records of the General Assembly, Seventy-first Session, Supplement No. 17* (A/71/17), para. 119.
[10] Ibid., para. 122.

agreed that a contractual text on secured transactions and a text on intellectual property licensing should be retained on its future work programme.[11] The Commission also decided that the following topics should be added on its future work programme: (a) micro-finance; (b) contractual issues relating to micro-enterprises (e.g. transparency issues); (c) warehouse receipt financing; and (d) alternative dispute resolution ("ADR") and secured finance.[12] The Commission agreed all those issues should be considered at a future session on the basis of notes to be prepared by the Secretariat, after a colloquium or expert group meeting, to be held within existing resources.[13]

7. In accordance with the decision of the Commission at its forty-ninth session (see para. 6 above), the Secretariat organized the Fourth International Colloquium on Secured Transactions in Vienna from 15 to 17 March 2017. The purpose of the colloquium was to obtain the views and advice of experts with regard to possible future work on security interests and related topics. Approximately 100 experts from governments, international organizations and the private sector participated in this three-day event and the discussions thereof provided a basis for this note by the Secretariat. The papers submitted for the international colloquium are available on the UNCITRAL website and selected articles will be published in the Uniform Law Review in coordination with the International Institute for the Unification of Private Law ("Unidroit"). The considerations and conclusions reached at the Colloquium with respect to possible future legislative work are summarized below. The considerations and conclusions reached at the Colloquium with respect to possible future coordination and technical assistance work are summarized in document A/CN.9/919.

II. Possible future legislative work topics

A. Contractual issues

1. Introduction

8. The panel that discussed contractual issues considered a text that would provide guidance to parties to secured transactions as to the issues that should be addressed in a security agreement and ways in which those issues should be addressed based on generally acceptable international best practices. Discussion was based on the assumption that the UNCITRAL Model Law on Secured Transactions (the "Model Law") was in effect in all relevant jurisdictions and focused on a typical simple security agreement, leaving aside conflict-of-laws issues.

2. Desirability

9. In the discussion that followed, some doubt was expressed as to whether there was a need for a contractual guide that would provide guidance to parties or whether UNCITRAL would be the most appropriate body to prepare such a contractual guide with sample security agreements. However, there was broad support for the suggestion that the text to be prepared could take the form of an addendum to the draft Guide to Enactment of the Model Law with interpretation or another form (e.g. a practice guide). In this connection, it was noted that the draft Guide to Enactment of the Model Law was mainly addressed to legislators. Thus, the suggestion was made that the draft Guide to Enactment could be expanded or supplemented to provide guidance to users (such as judges, arbitrators, parties to transactions, practitioners, and academics) of the Model Law and the Registry it envisages. The view was widely shared that, without such guidance, parties may not be able to use the Model Law to their benefit. Empirical evidence suggests, for example, that, even in States that have adopted modern secured transactions law,

[11] Ibid., para. 124.
[12] Ibid., para. 125.
[13] Ibid.

lenders that are not familiar with financing practices relating to movable property, such as inventory and receivables financing, keep requiring mainly immovable property as security for credit. Where the vast majority of immovable property is owned by a small percentage of the population of a State, this means that, despite the adoption of a modern secured transactions law, credit is not available to the sector of the economy that needs it the most, that is, small and medium-size enterprises ("SMEs").

3. Feasibility

10. The following paragraphs briefly summarize panel considerations with respect to the issues that should be addressed and ways in which those issues could be addressed in a text to be prepared by the Commission.

(a) Types of secured transaction enabled by the Model Law

11. The text could explain the special characteristics and advantages of the types of secured transaction made possible by the Model Law (e.g. inventory and equipment acquisition financing, inventory and receivables revolving loan financing, factoring and forfaiting, securitization, term loan financing, credit secured by transfer of title). The text could also discuss which provisions of the Model Law and exactly how they made possible these types of secured transaction.

(b) Pre-contractual issues

12. The text could discuss the goals of secured creditor and grantor, as well the necessary initial documents (e.g. secured creditor's non-binding indication of interest, proposal letters with sample forms, valuation of proposed collateral, and secured creditor's binding letter of commitment stating the amount of the loan, interest rates and fees).

(c) Due diligence

13. The text could discuss due diligence issues (e.g. search certificates with sample forms, perfection certificates, essential information about the grantor and the proposed collateral with sample forms, searches in secured transactions and other specialized registries, and searches about judgements and tax liens).

(d) Clear and simple drafting

14. The text could explain the benefits of clear drafting (e.g. to avoid disputes, ensure that parties understand the terms of the deal, use terms that correspond to the Model Law, take into account the experience and sophistication of the parties) and simple drafting (e.g. to avoid the use of legalistic words, long sentences and long paragraphs, use easy-to-read fonts, give examples of ineffective drafting).

(e) Party autonomy and mandatory provisions in the Model Law

15. The text could discuss article 3, paragraph 1, of the Model Law that enables parties to adapt their agreement to their needs, giving examples of particular articles of the Model Law which the parties may derogate from or vary by agreement (e.g. the definition of default under art. 2, subpara. (j) and the waiver of post-default rights after default under art. 72, para. 3). The text could also explain the mandatory provisions of the Model Law that are not subject to party autonomy giving examples (e.g. general standard of conduct of the parties under art. 4 and the conflict-of-laws provisions in arts. 85-107)

(f) Sample security agreement

16. The text could include sample security agreements based on widely acceptable international best practices. The text could also explain the key provisions of such a sample security agreement (e.g. identification of the parties, creation of a security

right, description of the collateral and the secured obligation, representations concerning the grantor and the collateral, events of default, and post-default remedies).

(g) Closing the deal

17. The text could discuss issues relating to the closing of the deal (e.g. pre-filing, post-closing confirmatory search, certificates, and disbursement of funds).

(h) Post-closing monitoring

18. The text could discuss issues relating to post-closing monitoring of the grantor and the collateral (e.g. change in grantor identifier, change in State of location of the grantor or tangible collateral, and change in the value of collateral).

(i) Third-party effectiveness and registration

19. The text could provide sample forms for making the security right enforceable against third parties by methods other than registration. It could also provide model forms and guidance for preparing and submitting the appropriate notice forms to a registry to make the security right effective against third parties by registration.

4. Conclusions

20. The Commission may wish to consider whether a text should be prepared to provide guidance to users of the Model Law as to how to best benefit from the Model Law and the Registry it envisages. This text could take the form of a guide to enactment, part II, of the Model Law. Alternatively, this text could take the form of a practice guide, such as the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation, which provides information for insolvency practitioners and judges on practical aspects of cooperation and communication in cross-border insolvency cases, or the UNCITRAL Notes on Organizing Arbitral Proceedings, which are designed to assist arbitration practitioners by providing an annotated list of matters on which an arbitral tribunal may wish to formulate decisions during the course of arbitral proceedings.

B. Transactional and regulatory issues

1. Desirability

21. There are matters external to the secured transactions law that can play a major role in determining whether a State has vibrant and well-functioning secured credit markets that further the overall goal of an efficient and effective secured transactions law to increase the availability of credit at lower cost by the use of movable property as security for obligations. These matters include “capacity-building” in particular among lenders and the development of regulatory standards appropriate for secured credit.

22. Capacity-building among lenders means the development by lenders of the practical ability to utilize the tools provided by modern secured transactions law to engage efficiently and profitably in credit transactions with reduced risk of loss from default. It is generally recognized that providing a State with a modern secured transactions law like that recommended by the UNCITRAL Legislative Guide on Secured Transactions (the “Secured Transactions Guide”) and exemplified in the Model Law does not automatically result in lenders in particular having the practical tools to extend credit in a meaningful way. Rather, lenders often do not embrace transactions newly made possible on a profitable basis by secured transactions law reform until the creditors have the practical capacity to use the new legal rules effectively. Thus, law reform without such capacity-building may not be effective in achieving its goal.

2. Feasibility

23. The following paragraphs briefly summarize panel considerations with respect to the issues that should be addressed and ways in which those issues could be addressed in a text to be prepared by the Commission.

(a) Valuation of collateral and explanation of basic terms

24. The text could discuss issues relating to the valuation of collateral (e.g. by professional appraisers). The secured credit bargain creates a legal right. But the amount of protection against loss that the bargain provides is determined by the value of the collateral and, in particular, by its value in the context in which the collateral is likely to be disposed of. Thus, determining how much risk of loss is reduced by collateral requires expertise in estimating the amount that would likely be received upon its disposition. The text could also explain terms, such as "borrowing base" to determine how much to lend, particularly in the context of revolving credit facilities and a changing mass of collateral. When debt is revolving and the collateral consists of a fluctuating mass of property with too many items to efficiently evaluate each one separately, determining the maximum amount to be borrowed can be complex. Secured lenders in such transactions develop expertise in concepts such as defining a borrowing base and the development of formulas to determine how much can be safely loaned against the collateral (e.g. lender will extend credit against 70 per cent of the face amount of "qualifying receivables").

(b) Administration of secured loans

25. The text could discuss issues such as account keeping and monitoring of the grantor and the collateral. Secured creditors need to trust, but also verify. Thus, they need to develop expertise in audit matters related to collateral, including continued existence, quantity, condition, and fluctuations in value.

(c) Extrajudicial repossession, disposition and distribution of proceeds of collateral

26. As extrajudicial enforcement of security rights may be unknown in a State that enacts the Model Law, the text could explain the extrajudicial exercise of post-default rights and in particular the protection of the grantor and third-party rights and the use of alternative dispute resolution methods. The text could also explain the notices to be given in the context of extrajudicial enforcement of a security right and provide sample forms. The text could also discuss secondary markets for the sale of collateral, including electronic platforms and their advantages and disadvantages.

(d) Collection of receivables

27. The text could discuss issues that require additional capacity such as collection of collateral in the form of receivables (or other rights to the payment of money, including debt securities). For example, collection from the debtor of a receivable requires different skills than repossessing and disposing of a piece of equipment, as: (a) debtors of receivables often do care about the identity of the creditor; (b) it can be difficult to find the debtor of a receivable; and (c) it may be necessary to use historical data or information about the debtors of receivables to place a value on receivables at time of transaction.

(e) Investment in legal capacity

28. The text could also discuss legal capacity as modern secured transactions law is complex, and the exercise of rights is governed by complex rules. It could also discuss additional legal expertise needed in related areas of law, particularly insolvency law.

(f) Enhancing access to credit and financial stability

29. The text could discuss coordination between the Model Law and capital requirements under the Basel Accords issued by the Basel Committee on Banking Supervision ("BCBS"), as without understanding the relevant issues (e.g. about eligible collateral under the Basel Accords), lenders may not be prepared to lend or may lend only a higher cost to borrowers. The approach in regulatory law reflects the assumption that secured creditors may be unable to swiftly liquidate movable property collateral because of the limited availability of secondary markets and the fact that security rights are often subordinated to competing claims (such as privileged claims). These considerations do not take into account that secured transactions law reforms increase legal certainty and market transparency.

3. Conclusions

30. Law reform alone is likely to be insufficient to fully generate the goals of modern secured transactions law. Rather, increased availability of credit at lower cost is more likely to follow if creditors and regulators are conversant with the benefits of the adoption of such reforms and develop the capacity to enter into and manage transactions that the reforms make possible and to regulate the soundness of bank creditors entering into such transactions. Moreover, implementation of such reforms is necessarily a task whose characteristics will depend to a significant extent on State-specific factors. Thus, the Commission may wish to consider whether a text should be prepared to address these transactional and regulatory issues. This text could take the form of a guide to enactment, part III, of the Model Law or a practice guide (see para. 20 above). Regulatory law issues could be addressed in cooperation with the relevant regulatory authorities, such as the BCBS.

C. Finance to micro-businesses

1. Desirability

31. Micro-businesses are a vital part of the world economy (i.e. over 90 per cent of all businesses). They are also particularly critically important in developing economies, and, therefore, devoting special attention to the special characteristics arising from their financing is desirable. The importance of micro-businesses was made clear by statistics prepared by the World Bank Group and was confirmed by those members of the panel working in this area in various parts of the world.

32. There are many issues arising from the financing of micro-businesses which do not necessarily arise in relation to the financing of larger businesses (including SMEs). Even where micro-businesses have access to credit, this is often from non-regulated non-bank financial institutions that are subject to limited supervision; and it is preferable if these micro-businesses are drawn into the regulated lending market. This is not only convenient from the perspective of monitoring a relevant part of the credit market in developing economies, but also because the regulation and control of these micro-businesses will help include them in the formal sector of the economy. This improves the chances of access to credit and increases the likelihood of good investment and lending decisions.

33. Most micro-businesses are unlikely to have immovable property to use as collateral. Thus, in order for them to have access to the regulated lending market, micro-businesses need to be able to offer other types of collateral. In addition, micro-businesses are often required to provide personal guarantees, from the entrepreneur himself or herself if the corporate form is used, as well as from family, friends and other entrepreneurs. A number of special situations arise as a consequence of this practice. The amount of collateral available is usually very limited and its type different to that often provided by larger businesses. Legal issues arise from the fact that the business and any guarantors are likely to be individuals. The fact that the amounts lent are very small may also have

consequences concerning the cost of the transaction and the behaviour of lenders, both at time of the origination and during the lifecycle of the credit.

34. These factors lead to various issues arising in relation to the operation of the Model Law. These include the method used for the various notifications required by the Model Law, many issues relating to enforcement and debt recovery generally, including the complexity of the enforcement procedure, which is not particularly suitable for individuals, and very small loans and the way in which guarantees from individuals work in conjunction with secured lending. Thus, there is a need to consider and explain how secured transactions (under the Model Law) generally work for micro-businesses, and perhaps have some special rules to address the issues mentioned (see further paras. 39 and 40 below).

35. Furthermore, the small size of the micro-business puts the trader in a poor bargaining position vis-a-vis financiers. This often creates problems of over-collateralization, an area where both banking supervision and regulation need to be involved if a solution is to be reached. It also can lead to abusive interest rates, especially concerning default interest rates. The small size of micro-businesses also makes the introduction of special rules in case of insolvency advisable.

2. Feasibility

36. The following paragraphs briefly summarize panel considerations with respect to the issues that should be addressed and ways in which those issues could be addressed in a text to be prepared by the Commission.

(a) Special features of micro-businesses and financing of micro-businesses

37. The specific features of micro-businesses and the issues arising from their financing is one of the issues that would need to be discussed. Micro-businesses are usually either individual traders or small family businesses, and loans are usually of low value, whether term loans or revolving facilities. The types of finance available (unsecured or secured by proprietary security rights or personal guarantees), and the types of collateral available would also need to be discussed.

(b) Types of micro-finance transaction

38. The various types of transaction that are particularly suitable for micro-businesses, and the ways in which traditional financing structures would need to be adapted should be discussed. Possible structures include inventory-based lending, the special requirements for receivables financing for micro-businesses and the use of cash collateral, currency and bank accounts, as well as personal guarantees.

(c) Notifications

39. There are a number of situations in which the Model Law requires notification to be sent to the grantor (e.g. Registry Provisions, art. 15, para. 2, and Model Law, art. 77, para. 2 (b), art. 78, para. 4 and art. 80, para. 2 (a)). Apart from article 15, paragraph 2 of the Model Registry Provisions, which specifies that the notice is to be sent to the registered address of the grantor unless the secured creditor knows of a more recent address, the Model Law does not specify in detail to where notification should be sent. This is particularly true in the enforcement provisions. When the grantor is a company, it will have a registered office to which a notice can be sent, and the secured creditor can be reasonably sure that the grantor will receive it or will not be able to deny that it has received it. When the grantor is an individual, particularly a sole trader, its address may well change reasonably frequently and the secured creditor will not necessarily know about this change. The same is true of an individual's e-mail address (if electronic notification is permitted). For secured creditors to be sure that notifications will be effective, which will affect their decision to extend secured credit to individual traders, it would be desirable to develop a simple system where the means of notification are captured at the inception of the transaction, the individual then has a duty to update

and the enforcement consequences flow from notification having been given to the to last address stored on the system. A written template of how to achieve this would be most useful. It should be borne in mind that notification is part of the balancing of interests between the ability of a creditor to enforce effectively (and out of court) and the protection of a debtor, and this balance may be different where the debtor is an individual trader or guarantor.

(d) Enforcement

40. A number of issues relating to enforcement arise where a business is very small, particularly where it is an individual trader, or where an individual gives a guarantee. For example, it is first necessary to consider the protection of personal assets on enforcement. In addition, the out-of-court remedies provided in the Model Law may be too complicated and costly for very low-value loans. In relation to enforcement of security rights securing very small loans, a simplified out-of-court procedure may be needed with some protection for the debtor built in. Moreover, it may be necessary to move towards a "small claims" court model to facilitate enforcement by means of pre-designed templates with limited access to appeal, and/or to consider the use of Alternative Dispute Resolution (whether physical or online) as alternatives to court proceedings.

(e) Personal guarantees

41. Personal guarantees, which are often given by family, friends or mutualized organizations of micro-businesses, raise issues of protection of the guarantor, such as problems raised by household insolvency and the coordination of insolvency proceedings. It would be necessary to consider whether there should be special rules in relation to personal guarantees, and, in particular, in relation to their interaction with secured lending.

(f) Regulatory capacity issues

42. Inequality of bargaining power often leads to unfair terms in loan and security agreements. Thus, unfair terms, such as high default interest rates, unfair termination clauses and definitions of events of default, should be discussed together with ways in which their unfairness could be addressed. The regulation of bank behaviour in relation to lending to micro-businesses would also need to be discussed. Problems here include the fact that the very small size of loans reduces incentives on lenders to do a proper risk assessment, paving the way for the over-collateralization of the loans facilitated by the drastic inequality in bargaining power. Practice also shows that deficient monitoring and inefficient reactions in case of distress of the loan take place, in particular, the common practice of the "evergreening" of the loans. "Evergreening" causes problems from both sides of the lending process. Banks refinance almost blindly, without previously assessing the viability of the borrower (and hence of the likelihood of future repayment), which has the consequence of undermining the veracity of balance sheets of banks. On the other hand, this failure by creditors to enforce loans because their small size makes enforcement too expensive has a detrimental effect on micro-businesses as interest continues to accrue, making the loan virtually impossible to repay.

43. Possible solutions to these problems include more reliable information on which credit can be properly assessed (through efficient credit reporting systems), better monitoring practices and more efficient distribution of tasks within financial institutions, adequate implementation of the regulatory framework concerning non-performing loans, and perhaps even a redesign of enforcement mechanisms, which should be made cheaper, quicker and easier (see para. 40 above).

3. Conclusions

44. To address the issues identified above, the Commission may wish to consider preparing a text that would: (a) explain the application of the Model Law to security

interests in movable assets of a micro-business; (b) include model rules on issues, such as notifications to be given under the Model Law and enforcement; (c) include commentary and perhaps rules on personal guarantees; and (d) discuss legal capacity, transactional capacity and regulatory capacity, addressing the points outlined above. The form of work could be determined by the Working Group and different aspects of work can be addressed in various ways. For example, security interests created by micro-businesses could be addressed in model rules to be added to the Model Law and the commentary on those rules could be added to the Guide to Enactment of the Model Law. Other issues, such as personal guarantees, could be addressed in model rules or in a legislative or practice guide (see paras. 20 and 30 above). Any future work may need to be coordinated with other work of the Commission (e.g. on simplified incorporation or insolvency of micro-businesses). Regulatory law issues could be addressed in cooperation with the relevant regulatory authorities, such as the BCBS (see para. 30 above).

D. Warehouse receipts

1. Desirability

45. Warehouse receipts have many commercial uses, including to facilitate sales and distribution of commodities and to allow businesses to secure credit. Warehouse receipt financing allows producers (exporters) and global traders (importers) of agricultural commodities or other assets to access loans using warehouse receipts issued against assets deposited in warehouses as collateral. As several studies have shown, warehouse receipts are underutilized in international trade as a tool for gaining access to credit because of the lack of enabling legislation.[14] A primary barrier to the use of warehouse receipts financing is a lack of enabling legislation.[15] Another problem is the risk of fraud associated with warehouse receipts financing. However, an integrated and properly supervised system of electronic warehouse receipts can provide more security against fraud and mismanagement than paper-based systems. Moreover, warehouse receipts that are issued in electronic and negotiable form may lead to the establishment of commodity exchanges, thereby providing greater liquidity to producers, distributors and lenders.

46. One economic sector that suffers greatly from a lack of access to reasonably priced credit and the unavailability of warehouse receipts is agriculture. A number of international organizations, including the International Bank for Reconstruction and development (the “World Bank”), the European Bank for Reconstruction and Development (the “EBRD”), the Food and Agriculture Organization (the “FAO”) and the Organization of American States (the “OAS”) have examined and proposed mechanisms to address these challenges, such as by facilitating adoption of warehouse receipts laws. At the moment, no international or regional organization has adopted a model law on warehouse receipts, resulting in a lack of harmonization and ad hoc approaches. The absence of a model framework presents challenges, particularly for cross-border supply-chain transactions.

47. UNCITRAL has developed modern instruments, including the UNCITRAL Model Law on Electronic Commerce and the United Nations Convention on Contracts for the International Carriage of Goods Wholly or Partly by Sea (Rotterdam Rules), to facilitate the use of transportation documents and bills of

[14] See, for example, *Access to commodity finance by commodity-dependent countries,* Note by the UNCTAD Secretariat, United Nations Doc. TD/B/C.1/MEM.2/10 (2010), 9-10; OAS Inter-American Juridical Committee, *Principles for Electronic Warehouse Receipts for Agricultural Products*; APEC Secretariat, *Regulatory Issues Affecting Trade and Supply Chain Finance*, 2015, 13-14; World Bank Group, A Guide to Warehouse Receipts Financing Reform: Legislative Reform (2016); FAO and EBRD, Designing Warehouse Receipt Legislation: Regulatory Options and Recent Trends (2015).

[15] OAS Principles, supra. No. 14, at 6; APEC Economic Committee, *Report on Workshop on Supply Chain Finance and Implementation of Secured Transactions in a Cross-Border Context*, August 20-21, 2016 (APEC doc 2016/SOM3/EC/040) at 4.

lading in particular, issued both in paper and electronically. Thus far, UNCITRAL has not addressed warehouse receipts and in particular non-negotiable warehouse receipts.

48. Various laws often pose impediments to the utilization of assets, such as growing crops, as collateral for loans. The Model Law seeks to ameliorate these challenges, both at the pre- and post-harvest stage. For the post-harvest stage, it provides clear and modern rules on the utilization of negotiable documents, including warehouse receipts, as collateral for loans. However, given its nature, it defers to the domestic law to determine a number of issues, including: (a) which documents are negotiable; (b) who may issue warehouse receipts; (c) what are the rights and duties of parties to a warehouse receipt; and (d) what are the rights of buyers of warehouse receipts and products covered by them. A significant majority of economies, especially in States with developing economies, lack any warehouse receipt legislation or have legislation that is outdated.

49. Furthermore, both the Model Law and the Secured Transactions Guide were prepared against the background of negotiable instruments and negotiable documents issued in paper form. Under these texts, a security right in negotiable instruments or negotiable documents can only be made effective against third parties by registration or by possession; and possession is defined to mean "actual possession of the tangible asset". No reference is made to the fact that "control" has become the primary mechanism for outright transfers and third-party effectiveness of security rights in "electronic assets", especially warehouse receipts which are increasingly issued electronically. The Secured Transactions Guide points out that "in view of the particular difficulty of creating an electronic equivalent of paper based negotiability", if an enacting State "wishes to address this matter [it] will need to devise special rules".[16] No such rules are provided in the Model Law or the Secured Transactions Guide. Nonetheless, the Secured Transactions Guide notes that the failure to address electronic negotiable documents of title "should not be interpreted as discouraging the use of electronic equivalents of paper negotiable instruments or negotiable documents".[17] And the draft Guide to Enactment of the Model Law notes that "the enacting States may wish to consider whether to include in their enactment of the Model Law an article along the lines of recommendation 12 [Electronic communications] of the Secured Transactions Guide".[18]

50. The draft Model Law on Electronic Transferable Records provides a general framework for the issuance and transfer of electronic records, including electronic warehouse receipts. But it does not address many aspects typically regulated by warehouse receipts and secured transactions laws, such as the priority rights of a person in control of an electronic warehouse receipt as against competing claimants. Neither the draft Model Law on Electronic Transferable Records nor the Model Law on Secured Transactions explain how a security right in inventory might automatically flow into the related electronic warehouse receipt or into the proceeds involving an electronic negotiable invoice generated from the sale of that inventory.

2. Feasibility

51. The work done so far by other organizations mentioned above is a good indication of the likelihood that the Commission could successfully prepare a text on warehouse receipts (e.g. in the form of a model law). Expected participation of these international organizations in this project would ensure a quality product that could be immediately deployed in reform projects and within a relative short timeframe. For the security right aspects, this text could build on the principles, recommendations and model provisions enshrined in the UNCITRAL texts on security rights, and for the provisions addressing transferability of electronic warehouse receipts on the work of UNCITRAL in the area of electronic transferable

[16] UNCITRAL Legislative Guide on Secured Transactions, 459, footnote 13.
[17] Ibid., chap. I, para. 121.
[18] A/CN.9/914, para. 66.

records. In determining the feasibility of the proposed project, the Commission may wish to take into account the following issues:

(a) Clear definitions of key concepts and terms, including the warehouse receipt;

(b) Information required in a warehouse receipt;

(c) The form in which a warehouse receipt may be issued;

(d) Negotiable and non-negotiable warehouse receipts;

(e) Fundamental duties of warehouse operators;

(f) Responsibility for loss of or damage to stored goods;

(g) Irregularities, misdescription in and over-issue of warehouse receipts;

(h) Transfers of warehouse receipts, by negotiation, assignment, control or otherwise;

(i) Rights of transferees of warehouse receipts;

(j) Rights of buyers of goods covered by warehouse receipts;

(k) Substitution and removal of goods from the warehouse;

(l) Termination of storage;

(m) Third-party effectiveness of security rights in electronic warehouse receipts;

(n) Third-party effectiveness of security rights in non-negotiable warehouse receipts;

(o) Warehouseman's lien and its enforcement; and

(p) Transitional matters.

52. The Commission may also wish to consider giving the mandate to a working group to examine and provide guidance on additional aspects of warehousing, either for inclusion in the text to be prepared or in a separate text (e.g. a guide to enactment, if the text to be prepared takes the form of a model law), such as:

(a) Licensing of warehouses;

(b) Regulation of warehouses;

(c) Insurance and bonding of warehouses;

(d) Maintenance of adequate reserves; and

(e) Maintenance of accounting records.

3. Conclusions

53. The Commission may wish to consider preparing a text on warehouse receipts. This text could provide, inter alia, a modern general framework for the issuance and transfer of warehouse receipts, the duties and rights of issuers and holders of warehouse receipts, and the allocation of losses in case of a shortage in the tangible assets covered. The proposed text could also address the use as collateral for credit of warehouse receipts that are not negotiable documents and especially the third-party effectiveness of security rights in electronic warehouse receipts. Any work on the subject should be conducted in consultation with other international organizations that have been involved in supply chain and warehouse receipt finance, especially the United Nations Conference on Trade and Development ("UNCTAD"), Unidroit, the FAO, the EBRD, the OAS and the World Bank.

E. Intellectual property licensing

1. Desirability

54. The panel that dealt with intellectual property licensing first discussed the need for a uniform law text on intellectual property licensing due to its growing importance in world commerce. The panel pointed to: (a) studies from 1998 to 2013, according to which the index of global exports in goods grew by about 20 per cent, but royalty payments for intellectual property more than quadrupled over the same period; and (b) studies from 1990 to 2009, according to which the share of developing countries in global technology payments doubled from approximately 13 per cent to 26 per cent.

55. However, the panel noted a gap in the law with respect to contractual matters. While some intellectual property laws contain a few provisions addressing contract terms, there is no general commercial law directed specifically to intellectual property licensing. Instead, contracting parties must rely on a general intellectual law merchant based on ad hoc rules and practices that often require specialized knowledge and experience. This causes increased transaction costs and barriers to international trade, and puts small and medium-size enterprises at a disadvantage.

56. The panel referred to studies that show the benefits that States derive from increased intellectual property commerce. These benefits include: (a) superior access to finance and venture capital; (b) higher quality utilization of national human capital; (c) increased local inventive activity; (d) better access for local firms to technology: and (e) streamlined and enhanced access for the public to creative content. Realizing these benefits also requires legal support for commercial transactions in intellectual property, e.g. “licensing.” The lack of a general commercial law text specially crafted to the unique needs of intellectual property licensing constitute a barrier to realization of these benefits.

57. The panel also referred to other specialized texts that address distinctive commercial transactions. A premier example is the United Nations Convention on Contracts for the International Sale of Goods (the “CISG”). Other texts mentioned are the Model Law, the Cape Town Convention on International Interests in Mobile Equipment, and the Unidroit Principles of International Commercial Contracts. It was mentioned that, unfortunately, none of these instruments are specifically tailored to the unique requirements of intellectual property licensing.

58. The panel noted that the Model Law applies also to transactions in which intellectual property (including licence royalties) is used as collateral for credit. It was pointed out that it would be a natural outgrowth of the Commission’s work to also provide a uniform text for commercial contracts for the use of intellectual property. The panel concluded that a project on intellectual property licensing would be highly desirable for world commerce and a natural adjunct to the Commission’s other work.

2. Feasibility

59. To establish the feasibility of the preparation of a uniform law text on intellectual property licensing, the panel then discussed a range of commercial issues that arise in typical intellectual property licensing contracts and ways in which they could be usefully addressed. These issues include the following:

(a) Scope of work: the proposed text should address intellectual property licensing issues that could be addressed with non-mandatory law rules that the parties could vary or derogate from, with the understanding that the text is not intended to alter provisions of intellectual property law;

(b) Definitions and rules of interpretation: terms, such as “assignment”, “licence”, “exclusive”, “scope”, “use”, and other terms that would appear in the text, would need to be defined; also reference would need to be made to the general obligation of good faith and reasonable conduct;

(c) Contract formation: the question would need to be addressed whether there should be any special rules for the formation of an intellectual property licensing contract apart from a State's general contract law rules on matters, such as written form and contract formation by electronic means; in this regard, it may be useful to review the Unidroit Principles of International Commercial Contracts;

(d) Contract interpretation: a number of questions would need to be addressed, including whether: (i) the parties may agree to limit interpretation solely to the terms of a written instrument; (ii) if the written instrument is ambiguous, it is then proper to look to the conduct of the parties; (iii) a contract should be interpreted by neutral rules or whether there should be a rule in favour of one party (e.g. an author); and (iv) it is necessary to address interpretation of terms that call for successive performances, or that require performance to the satisfaction of the other party;

(e) Implied terms: the text would need to address the question whether an intellectual property licensing contract should be deemed to include implied terms, such as an implied representation about ownership or control of the intellectual property by the licensor, or a duty of cooperation, or mutual obligations to act in good faith;

(f) Obligations and their performance: it may be necessary to address the general obligations of the parties (e.g. the licensor to enable use and the licensee to use according to the terms of the licence and pay royalties) and their performance;

(g) Transfer of rights and acceptance of duties: it may be necessary to address transfers of intellectual property rights by a licence agreement and transfers of contractual rights, for example, by an assignment of a right to payment, and to distinguish acceptance of duties from a transfer of rights;

(h) Breach of contract and remedies: it may be necessary to address situations that would constitute breach of an intellectual property licensing contract and the relevant remedies (e.g. whether exact or substantial performance is required, whether a distinction would need to be made between a breach that allows ending the contract and one that only allows damages, the measure and type of damages); and

(i) Conflict-of-laws issues: the law applicable to an intellectual property licensing contract may also need to be discussed and in particular whether the parties may choose it and, if so, what matters may be covered by the law chosen by the parties.

3. Conclusions

60. The Commission may wish to consider whether a text should be prepared on intellectual property licensing or whether the matter should be retained on its future work agenda for further consideration at a future session on the basis of a note to be prepared by the Secretariat within existing resources (the same approach may be followed with respect to any issue with respect to which the Commission may not be ready to decide whether it should undertake any work). Any future work may be undertaken in cooperation with relevant international governmental organizations, such as the World Intellectual Property Organization ("WIPO") and international non-governmental organizations.

F. Alternative dispute resolution in secured transactions

1. Desirability

61. The panel that dealt with ADR in secured transactions agreed that ADR, including arbitration, mediation and conciliation (whether conducted physically or online), should be available for the resolution of disputes arising with respect to security agreements or security rights (these are post-default disputes typically

arising during enforcement of a security right). The panel also agreed that ADR is particularly important where court proceedings are inefficient, as problems, such as inordinate delays and cost, are bound to have a negative impact on the availability and the cost of credit.

62. However, laws differ on the extent to which such disputes may be resolved by arbitration. In addition, it is not clear that, where such disputes are resolved by arbitral proceedings, the rights of third parties are fully addressed in the case of enforcement of a security right in an asset. Moreover, while mediation or conciliation should in principle be possible, as it does not involve a binding decision, it is not clear that it could be used as an alternative to judicial proceedings in the enforcement of a security right. Mediation or conciliation could reduce the workload of courts and help parties achieve a balanced solution that both protects their rights and the rights of third parties, and makes low-cost credit available.

63. Article 3, paragraph 3, of the Model Law provides that "nothing in this Law affects any agreement to use alternative dispute resolution", thus referring the issue of arbitrability to other applicable law. Thus, the Model Law does not address the issue of arbitrability.

64. In addition, article 73 of the Model Law provides that a secured creditor may exercise its post-default rights by application to a court or other authority to be specified by the enacting State, or without such an application. The draft Guide to Enactment explains that "other authority" means an authority vested with adjudicative powers by a State (see A/CN.9/914/Add.5, para. 57). So, it seems that an arbitral tribunal would not qualify as such an authority. However, enforcement without application to a court or other authority may in principle include enforcement by arbitration, even though the matter is not expressly addressed in the Model Law or the draft Guide to Enactment.

65. Moreover, the Model Law includes a number of provisions dealing with the rights of third-parties with rights in an encumbered asset that may be affected by the enforcement of a security right. More concretely: (a) article 74, option B, permits any third party to seek relief for non-compliance by the enforcing secured creditor with the provisions of the chapter on enforcement; (b) article 75, paragraph 1, permits any third party to terminate enforcement; (c) article 76, paragraph 1, permits a higher-ranking secured creditor to take over enforcement; (d) article 77, paragraph 2, requires the enforcing secured creditor to give notice of default to any third party in possession of an encumbered asset and permits any such third party to prevent the out-of-court re-possession of the encumbered asset by the secured creditor; (e) article 78, paragraph 4, requires the enforcing secured creditor to give notice to third-party creditors of its intention to dispose of an encumbered asset out of court; (f) article 79, paragraph 2, requires the secured creditor to follow certain rules in distributing the proceeds of an out-of-court disposition of an encumbered asset; and (g) article 80, paragraph 2, requires the enforcing secured creditor to send the proposal for the acquisition of an encumbered asset to third-party creditors.

66. Moreover, where a person in possession objects to the out-of-court re-possession of an encumbered asset by the secured creditor, the secured creditor may seek to resolve the dispute by an ADR mechanism. For example, if the issue is not explicitly stated in other law as an issue with respect to which arbitration is not allowed, the grantor and the secured creditor may agree to arbitrate, as long as third-party rights are not affected; and mediation or conciliation (whether physical or online) should in principle be possible, if the parties agree, since by definition mediation or conciliation do not result in a binding decision and in particular third-party rights are not affected.

2. Feasibility

67. Like any other agreement, a security agreement creates rights and obligations for the parties, the grantor and the secured creditor. So, in principle the parties could agree to resolve any dispute arising in that regard by arbitration. If the arbitral

award orders the debtor to pay and the secured creditor attempts to enforce the award by seizing the encumbered asset, the rights of third parties with rights in the encumbered asset should be protected.

68. For example, article 68 of the Model Inter-American Law on Secured Transactions deals with the issues of arbitrability as it provides that: "Any controversy arising out of the interpretation and fulfilment of a security interest may be submitted to arbitration by the parties, acting by mutual agreement and according to the legislation applicable in this State" (no reference is made though to mediation or conciliation).

69. Article 78 of the Colombian secured transactions law goes further and provides that: "If the parties so decide, any controversy that arises with respect to the creation, interpretation, perfection, performance, enforcement and liquidation of a security interest can be subject to conciliation, arbitration, or any other alternative dispute resolution mechanism, according to national legislation and applicable international treaties and conventions". However, it should be made clear that parties to secured transactions may be allowed to commence arbitration when they wish and be trusted that they would not skip negotiations, mediation or conciliation if these dispute-resolution methods carry a realistic hope of success (i.e. multi-tiered dispute resolution clauses may not be suitable in all cases).

70. In the case of judicial enforcement of a security right, the protection of rights of third-party creditors is a matter of the law governing judicial enforcement. In the case of out-of-court enforcement, this protection should be addressed in secured transactions law along the lines set out above (see para. 65 above).

3. Conclusions

71. The Commission may wish to consider whether a model rule along article 68 of the Model Inter-American Law on Secured Transactions or article 78 of the Colombian secured transactions law should be prepared and added to the Model Law, and whether commentary on that model rule should be included in the draft Guide to Enactment. The model rule could require parties to seek a resolution of an enforcement-related dispute first by negotiation and then by mediation or conciliation. The parties could be allowed to go to a court or other authority only if negotiation, mediation or conciliation does not produce a solution within a reasonable period of time and unless the parties agree at any time to go to arbitration. The commentary could discuss all these options and in particular the use of ADR to resolve disputes arising in the context of the enforcement of a security right. In this context, the commentary could highlight in particular the ways in which third-party rights are protected under the Model Law in the case of out-of-court enforcement of a security right. Such work could be undertaken by a working group that would include experts in both secured transactions law and dispute settlement law. Any work could be undertaken in coordination with any work undertaken by the Commission on dispute settlement and issues relating to ADR and insolvency.

G. Real estate financing

72. In the context of the general discussion that took place at the close of the Colloquium, the suggestion was made that the Commission should prepare a text on real estate financing. In support, it was stated that States interested in reforming their secured transactions law needed guidance also with respect to real estate financing. In opposition, it was pointed out that real estate financing law was generally well developed and did not lend itself to unification at the international level.