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Security Interests**Draft legislative guide on secured transactions****Report of the Secretary-General****Addendum*****Contents**

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* This addendum is submitted four days less than the required ten weeks prior to the start of the meeting because ITLB was fully occupied with the preparation of other documents, including another eleven addenda of A/CN.9/WG.VI/WP.2, eight of which have already been submitted.

XII. Transition issues

A. General remarks

1. General rule as to pre-effective date transactions

1. In many cases, the rules embodied in new secured transactions legislation will be different from the rules in the law predating the legislation. Accordingly, such legislation should specify the date when it will enter into force (“effective date”).

2. As debts that are secured by rights in the debtor’s property are often payable over a long period of time, it is likely that there will be many rights created before the effective date of any new secured transactions legislation that will continue to exist, securing debts that are not yet paid, on the effective date of the new legislation. Therefore, another important decision that must be made with respect to any new secured transactions legislation is the extent, if any, to which the new legislation will govern transactions entered into prior to the effective date.

3. One possibility would be for the new legislation to apply prospectively only and, therefore, not to govern any transactions entered into prior to the effective date. While there is a certain logical appeal in such a solution, especially with respect to issues that arise between the debtor and the secured creditor, it would create significant problems. Foremost among those problems is that it would be quite difficult for parties to existing secured transactions to gain the advantages of the new legislation, which may be important in particular if the existence of rights created under the prior regime cannot be determined easily. Another problem is that, if the new legislation did not apply to pre-effective date transactions, priority conflicts between rights created before the effective date and those created after the effective date would be difficult to resolve and might be subject to old law indefinitely. As a result, significant economic benefits of the new legislation would be deferred for a substantial period.

4. Another possibility would be for the new secured transactions legislation to govern all secured transactions, including those already in existence, as of a designated effective date, with only such exceptions as are necessary to assure an effective transition to the new regime (see paras. 5-10). Such an approach would avoid the problems identified above.

2. Exceptions to the general rule

a. Disputes before a court or arbitral tribunal

5. When a dispute is in litigation (or a comparable dispute resolution system) at the effective date of the new legislation, the rights of the parties have sufficiently crystallized so that the effectiveness of a new legal regime should not change the outcome of that dispute. Therefore, such a dispute should not be resolved by application of the new legal regime.

b. Effectiveness of pre-effective date rights as between the parties

6. When a security right has been created before the effective date of new legislation, two questions arise regarding the effectiveness of that right between the debtor and the creditor. The first is whether a right that was not effective between the parties under old law, but would be effective if the new law applied should become effective on the effective date of the new law. The second question is whether a right that was effective between the parties under the old law but would be ineffective if the new law applied should become ineffective between the parties on the effective date of the new law. With respect to the first question, consideration should be given to making the right effective as of the effective date of the new law. With respect to the second question, a transition period might be created during which the right would remain effective between the parties, so that the creditor could take the necessary steps to make the right effective under the new law. At the expiration of the transition period, the right would become ineffective between the parties unless it had become effective under the new law.

c. Effectiveness of pre-effective date rights as against third parties

7. Different issues are raised as to the effectiveness against third parties of a right created before the effective date. As new legislation will embody public policy regarding the proper steps necessary to make a right effective against third parties, it is preferable for the new rules to apply to the greatest extent possible. It may, however, be unreasonable to expect a creditor whose right was effective against third parties under the previous legal regime to comply immediately with any additional requirements of the new law. Accordingly, a right that was effective against third parties under the previous legal regime but would not be effective under the new rules, should remain effective for a reasonable period of time (as determined by the new law) so as to give the creditor time to take the necessary steps under the new law.

8. If the right was not effective against third parties under the previous legal regime, but is nonetheless effective against them under the new rules, the right should be effective against third parties immediately upon the effective date of the new rules. After all, presumably the parties intended effectiveness as between them, and third parties are protected to the full extent of the new rules.

d. Priority disputes

9. An entirely different set of questions arises in the case of priority disputes. If relative priority between two competing rights in encumbered assets has been established before the effective date of new rules, and nothing has happened that would change the priority other than the effective date having been reached, stability of relationships suggests that the priority established before the effective date should not be changed. If, however, something occurs that would have had an effect on priority even under the previous legal regime, there is less reason to continue to utilize old rules to govern a dispute that has been changed by an action that took place after the effective date of the new rules. Therefore, there is a much stronger case for applying the new rules to such a situation.

10. If the priority dispute is between one party whose right was established before the effective date and another party whose right was established after the

effective date, however, each party has an interest in application of the rules that were in effect when its interest was established. In such a case, while it is preferable to have the new rules govern eventually, it may be appropriate to provide a transition rule protecting the status of the creditor whose right was acquired under the old regime while that creditor takes whatever steps are necessary to maintain protection under the new regime. The transition rule might also provide that creditor with priority to the same extent as would have been the case had the new rules been effective at the time of the original transaction and those steps had been taken at that time.

B. Summary and recommendations

11. New secured transactions legislation should specify a date as of which it will enter into force.

[Note to the Working Group: The Working Group may wish to consider the extent to which the new legislation should apply to all transactions, including those already in existence.]