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**Security Interests****Recommendations of the draft Legislative Guide  
on Secured Transactions****Note by the Secretariat****Contents**

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## **Recommendations of the draft Legislative Guide on Secured Transactions**

### **I. Key objectives**

#### **Purpose**

The purpose of the recommendations on key objectives is to provide a broad policy framework for the establishment and development of an effective and efficient secured transactions law. These recommendations could be included in a preamble of the secured transactions law as a guide to the underlying legislative policies to be taken into account in the interpretation of the law (hereinafter referred to as “the law”).

#### **Key objectives**

1. The following key objectives should be considered:
  - (a) Promote secured credit;
  - (b) Allow utilization of the full value inherent in assets to support credit in a broad array of credit transactions;
  - (c) Obtain security rights in a simple and efficient manner;
  - (d) Recognize party autonomy;
  - (e) Provide for equal treatment of diverse sources of credit;
  - (f) Validate non-possessory security rights;
  - (g) Encourage responsible behaviour on the part of all parties by enhancing predictability and transparency;
  - (h) Establish clear and predictable priority rules;
  - (i) Facilitate enforcement of creditor’s rights in a predictable and efficient manner;
  - (j) Balance the interests of affected persons; and
  - (k) Harmonize secured transactions laws, including conflict-of-laws rules.

### **II. Scope of application**

#### **Purpose**

The purpose of the scope provisions of the law is to specify the parties, the security rights, the secured obligations and the assets to which the law applies.

#### **Parties, security rights, secured obligations and assets covered**

2. The law should apply to all parties and types of security rights, secured obligations and encumbered assets. Any exceptions should be limited and clearly stated in the law.

3. In particular, the law should provide that it applies to:

(a) Legal and natural persons, including consumers, without, however, affecting their rights under consumer-protection legislation;

(b) Property rights created contractually to secure all types of obligations, including future obligations, fluctuating obligations and obligations described in a generic way;

(c) Possessory and non-possessory security rights in movable property and fixtures securing payment or other performance of one or more obligations, present or future, determined or determinable;

(d) All types of movable assets and fixtures, tangible or intangible, present or future, not specifically excluded in the law, including inventory, equipment and other goods, receivables, [negotiable instruments (such as cheques, bills of exchange and promissory notes), negotiable documents (such as bills of lading),] bank accounts [proceeds from the drawing under an independent undertaking and intellectual property rights];

*[Note to the Working Group: Negotiable instruments, negotiable documents, independent undertakings and intellectual property rights are within square brackets as the Working Group has not decided yet that they should be included in the scope of the Guide. If the Working Group decides that such types of asset should be covered in the Guide, it may wish to review the recommendations to ensure that both the recommendations applicable to all types of asset and the asset-specific recommendations are appropriate for those assets.]*

(e) Security rights acquired by way of transfer of title and all other types of rights securing the payment or other performance of one or more obligations, irrespective of the form of the relevant transaction and whether ownership of the encumbered assets is held by the secured creditor or the grantor, including the various forms of retention of title, financial leases and hire-purchase agreements;

(f) Generally, absolute transfers of receivables;

(g) Aircraft, ships and fixtures to the extent that the recommendations of this law are not inconsistent with existing laws or international obligations of the State relating to these assets. Where a direct inconsistency exists, the State's secured transactions law should expressly confirm that the other law and international obligations govern those assets to the extent of that inconsistency;

[(h) Intellectual property rights to the extent that the recommendations of this law are not inconsistent with existing laws or international obligations of the State relating to these assets. A State enacting secured transactions legislation in accordance with this Guide should consider whether it might be appropriate to adjust certain of the recommendations as they apply to security rights in intellectual property. In this regard, a State should examine its existing intellectual property laws and the State's obligations under intellectual property treaties, conventions and other international agreements and, in the event that the recommendations of the Guide are directly inconsistent with any such existing laws or obligations, the State's secured transactions law should expressly confirm that those existing intellectual property laws and obligations govern such issues to the extent of the inconsistency. In considering whether any adjustments of the recommendations as

they apply to security rights in intellectual property are appropriate, a State should analyse each circumstance on an issue-by-issue basis and should have proper regard both to establishing an efficient secured transactions regime and to ensuring the protection and exercise of intellectual property rights in accordance with international conventions and national laws.]

4. The law should not apply to security rights in:
  - (a) Securities;
  - (b) Real property, with the exception of fixtures;
  - (c) Wages;
  - (d) [...].

### **III. Basic approaches to security**

#### **Purpose**

The purpose of the recommendations on basic approaches to security is to ensure that the law covers in a comprehensive and consistent manner all forms of transactions that function as security.

#### **Comprehensive approach**

5. The law should include a comprehensive and consistent set of provisions on non-possessory security rights in tangibles and intangibles. The law should also provide for possessory security rights in tangibles.

#### **Functional approach**

6. The law should treat all devices that perform security functions as secured transactions, including the transfer of title to tangibles or the assignment of intangibles for security purposes, retention of title, financial leases and hire-purchase agreements, except to the extent otherwise contemplated in recommendation 7 .

#### **Unitary and non-unitary approach**

7. The law could subsume all devices that perform security functions into a unitary notion of security rights or preserve retention of title and similar devices as separate devices under other law but provide that the same rules applicable to security devices apply to the maximum extent possible.

### **IV. Creation of the security right (effectiveness as between the parties)**

#### **Purpose**

The purpose of the provisions of the law dealing with creation is to specify the way in which a security right in movable property is created.

*[Note to the Working Group: As the recommendations follow a unitary approach, the Working Group may wish to include at the end of each chapter alternative recommendations that follow a non-unitary approach as contemplated in recommendation 7 or a general recommendation drawing the attention of legislators to the need to adjust the recommendations if they decide to follow a non-unitary approach.]*

#### **Creation of a security right by agreement**

8. The law should specify that a security right is created by agreement between the grantor and the secured creditor which is in writing [signed by the grantor in accordance with recommendation 12] [that evidences the intent of the grantor to grant a security right] or is accompanied by delivery of possession pursuant to the agreement and in accordance with recommendation 9.

#### **Delivery of possession**

9. The law should provide that the delivery of possession of the assets to be encumbered is to the secured creditor or a third person (other than the grantor or an agent or employee of the grantor) that holds the assets on behalf of the secured creditor.

#### **Minimum contents of the security agreement**

10. The law should provide that the security agreement must, at a minimum, identify the secured creditor and the grantor, and reasonably describe the secured obligation and the assets to be encumbered. A generic description of the secured obligation and the encumbered assets should be sufficient.

#### **Form**

11. The law should specify that a writing requirement is met by an electronic communication if the information contained therein is accessible so as to be usable for subsequent reference (see article 6 of the UNCITRAL Model Law on Electronic Commerce).

12. [The law should also specify that, unless the law provides otherwise, where the law requires a signature of a person, that requirement is satisfied in relation to an electronic communication if:

(a) A method is used to identify that person and to indicate that person's approval of the information contained in the electronic communication message; and

(b) That method is as reliable as was appropriate for the purpose for which the electronic communication was generated or communicated, in the light of all the circumstances, including any relevant agreement (see article 7 of the UNCITRAL Model Law on Electronic Commerce).]

#### **Assets and obligations subject to a security agreement**

13. The law should specify that a security right may secure all types of obligation, including future, conditional and fluctuating obligations. It should also specify that a security right may be given in all types of asset, including parts of assets and

undivided interests in assets and assets which, at the time of the security agreement, the grantor may not yet own or have the power to dispose of, or which may not yet exist, as well as in proceeds. Any exceptions to these rules should be limited and described clearly in the law.

### **Receivables**

#### **Effectiveness of an assignment as between the assignor and the assignee and as against the account debtor**

14. The law should provide that the assignment of receivables that are not specifically identified, future receivables and parts of or undivided interests in receivables is effective as between the assignor and the assignee and as against the account debtor, as long as, at the time of the assignment or, in the case of future receivables, at the time they arise, they can be identified to the assignment to which they relate.

*[Note to the Working Group: Article 8 of the United Nations Assignment Convention.]*

#### **Effectiveness of an assignment made despite an anti-assignment clause**

15. The law should provide that:

(a) An assignment is effective as between the assignor and the assignee and as against the account debtor notwithstanding an agreement between the initial or any subsequent assignor and the account debtor or subsequent assignee limiting in any way the assignor's right to assign its receivables;

(b) If other law creates any obligation or liability of the assignor for breach of such an agreement, the other party to such an agreement may not avoid the contract from which the assigned receivables arise or the assignment contract on the sole ground of that breach;

(c) A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

*[Note to the Working Group: The Working Group may wish to consider whether recommendation 15, which is based on article 9 of the United Nations Assignment Convention should apply only to receivables listed in article 9 (3) of the Convention, i.e. receivables:*

*(a) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of real property;*

*(b) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;*

*(c) Representing the payment obligation for a credit card transaction; or*

*(d) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.]*

### **Transfer of rights securing the assigned receivables**

16. The law should provide that:

(a) Personal or property rights securing or supporting payment of the assigned receivable are transferred to the assignee without a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer such right and any proceeds to the assignee;

*[Note to the Working Group: The Working Group may wish to note that the commentary to this recommendation would clarify that the first sentence reflects the rule that accessory security rights follow the secured obligation automatically and the second sentence means that independent rights, if transferable, require a separate act of transfer.]*

(b) A right securing payment of the assigned receivable may be transferred notwithstanding any agreement between the assignor and the account debtor or other person granting that right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable;

(c) If other law creates any obligation or liability of the assignor for breach of such an agreement, the other party to such an agreement may not avoid the contract from which the assigned receivables arise or the assignment contract on the sole ground of that breach;

(d) A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

*[Note to the Working Group: The Working Group may wish to consider whether recommendation 16, which is based on article 10 of the United Nations Assignment Convention should apply only to receivables listed in article 10 (4) of the Convention (identical with the list in article 9 (3) reproduced under recommendation 15 above.)*

### **Principle of account debtor protection**

*[Note to the Working Group: Recommendations 17 to 23 are based on articles 15-21 of the United Nations Assignment Convention.]*

17. The law should provide that:

(a) Except as otherwise provided in this law, an assignment does not, without the consent of the account debtor, affect the rights and obligations of the account debtor, including the payment terms contained in the original contract;

(b) A payment instruction may change the person, address or account to which the account debtor is required to make payment, but may not change:

(i) The currency of payment specified in the original contract; or

(ii) The State specified in the original contract in which payment is to be made to a State other than that in which the account debtor is located.

**Notification of the account debtor**

18. The law should provide that:

(a) Notification of the assignment or a payment instruction is effective when received by the account debtor if it is in a language that is reasonably expected to inform the account debtor about its contents. It is sufficient if notification of the assignment or a payment instruction is in the language of the original contract;

(b) Notification of the assignment or a payment instruction may relate to receivables arising after notification and that notification of a subsequent assignment constitutes notification of all prior assignments.

**Discharge of the account debtor by payment**

19. The law should provide that:

(a) Until the account debtor receives notification of the assignment, it is entitled to be discharged by paying in accordance with the original contract;

(b) After the account debtor receives notification of the assignment, subject to paragraphs (c) to (h) of this recommendation, it is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the account debtor, in accordance with such payment instruction;

(c) If the account debtor receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, it is discharged by paying in accordance with the last payment instruction received from the assignee before payment;

(d) If the account debtor receives notification of more than one assignment of the same receivable made by the same assignor, it is discharged by paying in accordance with the first notification received;

(e) If the account debtor receives notification of one or more subsequent assignments, it is discharged by paying in accordance with the notification of the last of such subsequent assignments;

(f) If the account debtor receives notification of the assignment of a part of or an undivided interest in one or more receivables, it is discharged by paying in accordance with the notification or in accordance with this recommendation as if the account debtor had not received the notification. If the account debtor pays in accordance with the notification, it is discharged only to the extent of the part or undivided interest paid.

(g) If the account debtor receives notification of the assignment from the assignee, it is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment from the initial assignor to the initial assignee and any intermediate assignment have been made and, unless the assignee does so, the account debtor is discharged by paying in accordance with this recommendation as if the notification from the assignee had not been received. Adequate proof of an assignment includes but is not limited to any writing emanating from the assignor and indicating that the assignment has taken place.

(h) This recommendation does not affect any other ground on which payment by the account debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the account debtor.

#### **Defences and rights of set-off of the account debtor**

20. The law should provide that:

(a) In a claim by the assignee against the account debtor for payment of the assigned receivable, the account debtor may raise against the assignee all defences and rights of set-off arising from the original contract, or any other contract that was part of the same transaction, of which the account debtor could avail itself as if the assignment had not been made and such claim were made by the assignor;

(b) The account debtor may raise against the assignee any other right of set-off, provided that it was available to the account debtor at the time notification of the assignment was received by the account debtor;

(c) Notwithstanding paragraphs (a) and (b) of this recommendation, defences and rights of set-off that the account debtor may raise pursuant to recommendations 15 and 16 against the assignor for breach of an agreement limiting in any way the assignor's right to make the assignment are not available to the account debtor against the assignee.

#### **Agreement not to raise defences or rights of set-off**

21. The law should provide that:

(a) The account debtor may agree with the assignor in a writing signed by the account debtor not to raise against the assignee the defences and rights of set-off that it could raise pursuant to recommendation 20. Such an agreement precludes the account debtor from raising against the assignee those defences and rights of set-off;

(b) The account debtor may not waive defences:

(i) Arising from fraudulent acts on the part of the assignee; or

(ii) Based on the account debtor's incapacity;

(c) Such an agreement may be modified only by an agreement in a writing signed by the account debtor. The effect of such a modification as against the assignee is determined by recommendation 22, paragraph (b).

*[Note to the Working Group: Recommendation 21 is based on article 19 of the United Nations Assignment Convention, which refers to a signed writing only for a waiver of defences or its modification. If the Working Group decides not to refer to signature in recommendation 8, it may wish to reconsider the reference to signature in recommendation 21.]*

#### **Modification of the original contract**

22. The law should provide that:

(a) An agreement concluded before notification of the assignment between the assignor and the account debtor that affects the assignee's rights is effective as against the assignee, and the assignee acquires corresponding rights;

(b) An agreement concluded after notification of the assignment between the assignor and the account debtor that affects the assignee's rights is ineffective as against the assignee unless:

(i) The assignee consents to it; or

(ii) The receivable is not fully earned by performance and either the modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

(c) Paragraphs (a) and (b) of this recommendation do not affect any right of the assignor or the assignee arising from breach of an agreement between them.

### **Recovery of payments**

23. The law should provide that failure of the assignor to perform the original contract does not entitle the account debtor to recover from the assignee a sum paid by the account debtor to the assignor or the assignee.

### **[Negotiable instruments [and other non-payment obligations]]**

24. The law should provide that, if a security right has been effectively created in a negotiable instrument, the secured creditor also has a security right in accessory rights with respect to the negotiable instrument without a new act of transfer. Such accessory rights may include:

(a) Rights against guarantors with respect to the negotiable instrument; and

(b) Security rights securing the obligation of the obligor on the negotiable instrument.]

*[Note to the Working Group: Under recommendation 24, if A gets a note from B guaranteed by C and then grants a security right in the note to D, D gets a security right in the guarantee as well.]*

### **[Independent undertakings]**

25. The law should provide that a beneficiary may grant a security right in proceeds from a drawing under an independent undertaking.]

*[Note to the Working Group: "Proceeds from a drawing under an independent undertaking" is a defined term.]*

### **Bank accounts**

26. The law should provide that a security right in a bank account is effective as between the secured creditor and the grantor notwithstanding an agreement between the grantor and the depositary bank limiting in any way the grantor's right to create a security right in its bank accounts. However, the security right is not effective against the depositary bank, the depositary bank has no duty to recognize the secured creditor and no obligations are otherwise imposed on the depositary bank with respect to the security right, without the depositary bank's consent.

27. Consistent with consumer-protection laws and policies, the law should deal with the question whether and to what extent a security right in a bank account may be created [or be subject to enforcement proceedings under this law] by an

individual grantor if the funds in the bank account or the credit extended to the individual grantor is for the grantor's personal, family or household purposes.

#### **[Negotiable documents of title]**

28. The law should provide that a security right in a negotiable document is also a security right in the goods represented by the document [, provided that the issuer is in possession of the document, directly or indirectly, at the time the security right in the document is created].

*[Note to the Working Group: The commentary may clarify that recommendation 28 is intended to negate that a separate security right needs to be created in the goods.]*

#### **Proceeds**

29. The law should provide that, unless otherwise agreed by the parties to the security agreement, the security right in the encumbered assets extends to the proceeds to the extent that the proceeds are identifiable in accordance with rules dealing with tracing that are also included in the law.

30. [The law should provide that, notwithstanding recommendation 29, the security right extends to civil and natural fruits of encumbered assets, such as [...], only if the parties so provide in the security agreement.]

*[Note to the Working Group: In order to reflect the normal expectations of parties, recommendation 30 introduces a different approach as to civil and natural fruits of encumbered assets from the approach taken in recommendation 29 with respect to other types of proceeds (the notion of "proceeds", as defined in the terminology section, includes civil and natural fruits).]*

#### **Fixtures**

31. The law should provide that a security right may be created or continue in fixtures in immovables under this law or real property law or fixtures in movables that have not lost their identity.

#### **Products or masses of goods**

32. The law should also provide that a security right may not be created in goods that are physically united with other goods in such a way that their identity is lost in another product or mass. However, if encumbered assets become part of another product or mass, the security right becomes a security right in the product or mass [proportionately] [up to the value of the encumbered assets at the time they are physically united with other goods].

*[Note to the Working Group: Under the first alternative, if the value of the flour is 5 and the value of the sugar is 5, while the value of the cake is 100, the secured creditors share the value of the cake 50 and 50. Under the second alternative, if the value of product or mass is higher than the value of the goods, the security right extends only to the value of the goods before commingling (i.e. each gets 5, while the remaining value of 90 is preserved for the grantor and its unsecured creditors). If the value of the product or mass is lower than the value of*

*the goods, the secured creditors share the loss proportionately (e.g. if the value of the cake is 8, each secured creditor gets 4).]*

**Time of creation**

33. The law should provide that, unless the parties otherwise agree, a security right becomes effective as between the parties at the time the security agreement is concluded or at the time the encumbered assets are delivered to the secured creditor.

34. The law should also provide that, unless the parties otherwise agree, a security right in future property is created when the grantor acquires rights or the right to transfer rights in such property.

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