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Draft Guide to Enactment of the draft Model Law on Secured Transactions

Note by the Secretariat

Contents

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I. Purpose of the Guide to Enactment

1. In preparing and adopting the [draft] UNCITRAL Model Law on Secured Transactions (the "Model Law"), the United Nations Commission on International Trade Law ("UNCITRAL" or the "Commission") was mindful of the fact that the Model Law would be a more effective tool for States modernizing their legislation and organizations assisting States, if background and explanatory information were provided to executive and legislative branches of Government to assist in their consideration of the Model Law for enactment ("Guide to Enactment").[1]

2. In addition, the Commission was aware that in the preparation of the Model Law it was assumed that the Model Law would be accompanied by such a guide. For example, it was decided in respect of a number of issues not to settle them in the Model Law but to address them in the Guide so as to provide guidance to States enacting the Model Law. So, the Guide also addresses or clarifies matters that were not settled in the Model Law but were referred to the Guide.[2]

3. The Commission agreed that the Guide to Enactment should be prepared and referred that task to the Working Group. In addition, the Commission agreed that the Guide to Enactment: (a) should be as short as possible; (b) include cross-references to the UNCITRAL Legislative Guide on Secured Transactions (the "Secured Transactions Guide") and the other texts of the Commission on secured transactions; (c) focus on giving guidance to legislators rather than users of the text; (d) explain the thrust of each provision or section of the Model Law and any difference with the corresponding recommendations of the Secured Transactions Guide or the provisions of another UNCITRAL text on secured transactions; (e) give guidance to States with respect to matters referred to them and in particular explain each option offered in various articles of the Model Law to assist enacting States in choosing one of the options offered.[3]

4. The Commission was also aware of the likelihood that the Model Law would be used in a number of States with limited familiarity with the type of secured transaction covered by in the Model Law. So, the Guide, much of which is drawn from the *travaux préparatoires* of the Model Law, is also intended to be helpful to other users of the text, such as judges, arbitrators, practitioners and academics.

5. The information presented in this Guide is intended to briefly explain the thrust of each provision or section of the Model Law and its relationship with the corresponding recommendation(s) of the Secured Transactions Guide, including the Supplement on Security Rights in Intellectual Property (the "Intellectual Property Supplement"), or other relevant UNCITRAL text on secured transactions. With respect to security rights in receivables, the recommendations of the Secured Transactions Guide and thus the provisions of the Model Law are based on the United Nations Convention on the Assignment of Receivables in International Trade (the "Assignment Convention"). The provisions of the Model Law dealing with the security rights registry (the "Registry") are also based on the UNCITRAL Guide on the Implementation of a Security Rights Registry (the "Registry Guide").

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[1] *Official Records of the General Assembly, Seventieth Session, Supplement No. 17* (A/70/17) para. 215.

[2] Ibid.

[3] Ibid., para. 216.

6. Mindful of the fact that the Secured Transactions Guide contains extensive commentary, the Commission decided that the Guide to Enactment should nevertheless be prepared. The reason was that the commentary of the Secured Transactions Guide had a different structure and did not contain a straightforward discussion of each recommendation but rather a discussion of the comparative advantages and disadvantages of various workable approaches with the recommendation being set out as a conclusion of that discussion. At the same time, as mentioned above, to avoid repetition, the Commission agreed that the draft Guide to Enactment should not repeat, but rather incorporate by reference, those comments contained in the Secured Transactions Guide that could assist in explaining a provision of the Model Law.

7. The Guide to Enactment was prepared by the Secretariat pursuant to the request of the Commission and is based on the considerations of the Working Group and the Commission. [It was considered and approved in principle by the Working Group at its twenty-eighth and twenty-ninth sessions (see […] respectively) and by the Commission at its forty-ninth session (see […]).]

II. Purpose and origin of the Model Law

A. Purpose of the Model Law

8. The Model Law is designed to assist States in implementing the recommendations of the Secured Transactions Guide, the Intellectual Property Supplement and the Registry Guide with respect to security rights in movable assets. The overall objective of those texts and the Model Law is to promote low-cost credit by enhancing the availability of secured credit (see Secured Transactions Guide, rec. 1, subpara. (a)). Like all those texts, the Model Law is intended to be useful to States that do not currently have efficient and effective secured transactions laws, as well as to States that already have workable laws but wish to modernize their laws and harmonize them with the laws of other States whose secured transactions laws are generally consistent with the recommendations of those texts (see Secured Transactions Guide, Introduction, para. 1).

9. The provisions of the Model Law are based on the recommendations of the Secured Transactions Guide, including the Intellectual Property Supplement. The provisions of the Model Law dealing with the security rights registry (the “Registry”) are also based on the Registry Guide. The provisions of the Model Law on security rights in receivables are based on the recommendations of the Secured Transactions Guide, which in turn are based on the Assignment Convention.

B. Background

10. At its first session, in 1968, the Commission included the topic of security interests in goods in its future work programme.[4] At its third session in, 1970, the Commission discussed the topic and decided to request the Secretary-General to: (a) invite Governments to submit information on security interests in goods;

[4] Ibid., *Twenty-third Session, Supplement No. 16* (A/7216), paras. 40-48.

(b) make that information available to the Commission; and (c) prepare a study on conditional sales of goods and trust receipts.[5]

11. At its eighth session, in 1975, the Commission considered a note by the Secretariat entitled "Study on security interests" with an annex entitled "Legal principles governing security interests" (A/CN.9/102) and decided to request the Secretary-General to: (a) complete the study by including the law of additional countries; (b) continue the feasibility study on the possible scope of uniform rules on security interests in goods and, for this purpose, consult with interested international organizations and trade and financial institutions; and (c) submit a progress report to the Commission.[6]

12. At its tenth session, in 1977, the Commission considered two notes by the Secretariat entitled "Study on security interests" (A/CN.9/130 and A/CN.9/131) and a third note entitled "Note by the Secretariat on article 9 of the Uniform Commercial Code of the United States of America" (A/CN.9/132), and requested the Secretary-General to: (a) submit to the Commission a further report on the feasibility of preparing a uniform text on security interests and on its possible content; and (b) carry out further work on the subject in consultation with interested international organizations and banking and trading institutions.[7]

13. At its twelfth session, in 1979, the Commission considered a note by the Secretariat entitled "Security interests: feasibility of uniform rules to be used in the financing of trade" (A/CN.9/165) and requested the Secretariat to prepare a report setting out the issues to be considered in the preparation of uniform rules on security interests.[8]

14. At its thirteenth session, in 1980, the Commission considered a note by the Secretariat entitled "Security interests: issues to be considered in the preparation of uniform rules" (A/CN.9/186) and decided that no further work should be carried out and the subject should no longer be accorded priority as "the world-wide unification of the law of security interests in goods, for the reasons brought out in the discussions, was in all likelihood unattainable".[9] The main reason mentioned for this decision was that "the subject was too complex and for there to be reasonable expectations that uniform rules might be developed" because: (a) the concepts of security interests and title retention were understood differently in various legal systems and it would be difficult for many legal systems to make the adjustments necessary to accommodate the different concepts; and (b) the topic of security interests was closely connected with other areas of law, such as bankruptcy law, which would have to be unified or harmonized for the proposed model law to be effective.[10] At that session, a number of suggestions were made. One suggestion was that the Commission might wish to await the outcome of the work on retention of title by the Council of Europe and on factoring by the International Institute for the Unification of Private Law ("Unidroit"), before it undertook work of its own. Another suggestion was that, if further work were to be undertaken in the future,

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[5] Ibid., *Twenty-fifth Session, Supplement No. 17* (A/8017), paras. 139-145.
[6] Ibid., *Thirtieth Session, Supplement No. 17* (A/10017), paras. 48-63.
[7] Ibid., *Thirty-second Session, Supplement No. 17* (A/32/17), para. 37.
[8] Ibid., *Thirty-fourth Session, Supplement No. 17* (A/34/17), paras. 49-54.
[9] Ibid., *Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 28.
[10] Ibid., para. 26.

emphasis should be placed on the practical problems in respect of security interests in international trade.[11]

15. Developments in the years that followed made possible the work of the Commission on secured transactions. More concretely, in 1984, the European Committee on Legal Cooperation (CDCJ) decided to defer its work to a future session work on a draft Convention on Simple Reservation of Title.[12] The Committee considered that two issues needed to be studied further, namely the publicity to be given to the reservation of title (written form or registration) and the treatment of the reservation of title in the case of the buyer's insolvency.[13]

16. In 1988, at a diplomatic conference held in Ottawa, States adopted the Unidroit Convention on International Factoring (Ottawa, 28 May 1988).[14]

17. In 1997, the Commission adopted the UNCITRAL Model Law on Cross-Border Insolvency, which is designed to assist States to equip their insolvency laws with a modern legal framework to more effectively address insolvency proceedings concerning debtors that have assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

18. In 2001, the Commission adopted the Assignment Convention, dealing with security interests in, and outright transfers of, receivables in international trade. In that year, a diplomatic conference held in Cape Town adopted the Convention on International Interests in Mobile Equipment and the Aircraft Protocol. In 2004, the Commission adopted the UNCITRAL Legislative Guide on Insolvency Law, which provides a comprehensive statement of the key objectives and principles that should be reflected in a State's insolvency laws. As all this work set the stage for further work, in 2007, the Commission adopted the UNCITRAL Legislative Guide on Secured Transactions, the overall objective of which is to promote low-cost credit by enhancing the availability of secured credit. Subsequently, the Commission adopted further texts on insolvency[15] and security interests,[16] making possible the preparation of a model law on secured transactions.[17]

C. Preparatory work and adoption

19. At its fortieth session in 2007, the Commission decided that, after completion of the Secured Transactions Guide, future work should be undertaken with a view to preparing a supplement to the Guide dealing with security rights in certain types of

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[11] Ibid., para. 27.

[12] The draft Convention is contained in document CDCJ (83) 36, item 6. The decision is reflected in document CDCJ (84) 55, para. 59. However, work was adjourned indefinitely (see A/CN.9/475, para. 10).

[13] Ibid., para. 57.

[14] www.unidroit.org/instruments/factoring.

[15] See www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html.

[16] See www.uncitral.org/uncitral/en/uncitral_texts/security.html.

[17] For security interests texts prepared by UNCITRAL, Unidroit and the Hague Conference, see www.uncitral.org/uncitral/en/uncitral_texts/security/2011UNCITRAL_HCCH_Unidroit_texts.html.

securities (i.e. non-intermediated securities), taking into account work by other organizations, in particular Unidroit.[18]

20. At its fourteenth and fifteenth sessions, Working Group VI (Security Interests) had a preliminary discussion about its future work programme. During those sessions, several suggestions were made, including the following: (a) a supplement to the Guide dealing with security rights in securities not covered by the Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009; the "Unidroit Securities Convention"); (b) a legislative guide on registration of security rights in general security rights registries; (c) a model law on secured transactions based on the recommendations of the Guide; (d) a contractual guide on secured transactions; and (e) a contractual guide on intellectual property licensing (see A/CN.9/667, para. 141, and A/CN.9/670, paras. 123-126, respectively).

21. At its forty-second session, in 2009, the Commission noted with interest the future work topics discussed by Working Group VI at its fourteenth and fifteenth sessions (A/CN.9/667, para. 141, and A/CN.9/670, paras. 123-126, respectively). At that session, the Commission agreed that: (a) the Secretariat could hold an international colloquium early in 2010 with broad participation of experts from Governments, international organizations and the private sector; and (b) the Commission would be in a better position to consider and make a decision on the future work programme of the Working Group at its forty-third session on the basis of a note by the Secretariat.[19]

22. At its sixteenth and seventeenth sessions, Working Group VI engaged in a preliminary discussion of its future work programme (A/CN.9/685, para. 96, and A/CN.9/689, paras. 59-61). At the seventeenth session of the Working Group, some support was expressed for work on regulations on registration of security rights and a model law on secured transactions based on the recommendations of the Guide. With regard to a supplement to the Guide on security rights in certain types of securities, it was observed that that work would have to be limited to non-intermediated securities in view of the work done by Unidroit and the Hague Conference on Private International Law (the "Hague Conference") on intermediated securities (see the Unidroit Securities Convention and the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary; The Hague, 2006; the "Hague Securities Convention").

23. In accordance with the decision of the Commission at its forty-second session, an international colloquium on secured transactions was held in Vienna from 1 to 3 March 2010. The purpose of the colloquium was to obtain the views and advice of experts with regard to possible future work in the area of security interests. Approximately 100 experts from governments, international organizations and the private sector participated in this three-day event. The papers submitted for the international colloquium are available on the UNCITRAL website.[20] The following topics were discussed at the colloquium: (a) security rights in non-intermediated securities; (b) registration of security rights in movable assets; (c) security rights in

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[18] *Official Records of the General Assembly, Sixty-second Session, Supplement No. 17* (A/62/17 (Part I)), paras. 147 and 160.

[19] Ibid., *Sixty-fourth session, Supplement No. 17* (A/64/17), paras. 313-320.

[20] www.uncitral.org/uncitral/en/commission/colloquia/3rdint.html. Selected articles were published in the Uniform Law Review, NS-Vol. XV, 2010-2.

movable assets: a model law; (d) rights and obligations of the parties to a security agreement; and (e) intellectual property licensing (A/CN.9/702 and Add.1).

24. At its forty-third session, in 2010, the Commission had before it a note by the Secretariat on possible future work in the area of security interests (A/CN.9/702 and Add.1). The Commission agreed that four issues related to secured transactions law listed in document A/CN.9/702, paragraph 2(a)-(d), were interesting (non-intermediated securities, registration of security rights, a model law and a contractual guide on secured transactions) and should be retained on its future work agenda.[21] At the same time, in view of the limited resources available to it, the Commission agreed that it could not undertake work on all four issues at the same time and that, as a result, it should set priorities. In that regard, there was general agreement that priority should be given to work on registration of security rights in movable assets. At that session, the Commission decided that Working Group VI should be entrusted with the preparation of a text on registration of security rights in movable assets as a matter of priority. It was also agreed that other topics, such as security rights in non-intermediated securities, a model law based on the recommendations of the Guide and a text dealing with the rights and obligations of the parties should be retained in the future programme of Working Group VI for further consideration by the Commission at a future session on the basis of notes to be prepared by the Secretariat within the limits of existing resources.[22] With respect to intellectual property licensing, the Commission requested the Secretariat to prepare a study, within existing resources, that would identify specific topics and discuss the desirability and feasibility of the Commission preparing a legal text with a view to removing specific obstacles to international trade in the context of intellectual property licensing practices.[23]

25. At its forty-fifth session, in 2012, the Commission decided that, upon its completion of the Registry Guide, Working Group VI should undertake work to prepare a simple, short and concise model law on secured transactions based on the Secured Transactions Guide and consistent with all texts prepared by UNCITRAL on secured transactions.[24] At that session, the Commission noted that the Working Group, at its twenty-first session, had agreed to propose to the Commission that the Working Group should develop a model law on secured transactions based on the general recommendations of the Secured Transactions Guide and consistent with all the texts prepared by UNCITRAL on secured transactions. It was also noted that the Working Group had agreed to propose to the Commission that the topic of security rights in non-intermediated securities should be retained on its work agenda and be considered at a future session (A/CN.9/743, para. 76).[25]

26. Recalling that, at its forty-third session, in 2010, the Commission had agreed that the topics mentioned above should be retained on the programme of the Working Group for further consideration, the Commission considered the proposals of the Working Group. It was widely felt that a simple, short and concise model law on secured transactions could usefully complement the Secured Transactions Guide

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[21] *Official Records of the General Assembly, Sixty-fifth session, Supplement No. 17* (A/65/17), para. 264.

[22] Ibid., para. 268.

[23] Ibid., para. 273.

[24] Ibid., *Sixty-seventh Session, Supplement No. 17* (A/67/17), para. 105.

[25] Ibid., para. 101.

and would be extremely useful in addressing the needs of States and in promoting implementation of the Secured Transactions Guide. While a concern was expressed that a model law might limit the flexibility of States to address the local needs of their legal traditions, it was generally viewed that a model law could be drafted in a sufficiently flexible manner to adapt to various legal traditions. Moreover, there was support for the idea that a model law could greatly assist States in addressing urgent issues relating to access to credit and financial inclusion, in particular for small and medium-sized enterprises.[26]

27. As to the topic of security rights in non-intermediated securities, it was widely felt that the topic merited further consideration. The Commission noted that non-intermediated securities, in the sense of securities other than those credited to a securities account, that were used as security for credit in commercial finance transactions were excluded from the scope of the Secured Transactions Guide (see recommendation 4, subparas. (c)-(e) of the Guide), the Unidroit Securities Convention and the Hague Securities Convention.[27]

28. At its twenty-third session, in 2013, Working Group VI had a general exchange of views on the basis of a note prepared by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.55 and Add.1 to 4).

29. At its forty-sixth session, in 2013, the Commission agreed that the preparation of the draft Model Law was an extremely important project to complement the work of the Commission in the area of security interests and provide urgently needed guidance to States as to how to implement the recommendations of the Secured Transactions Guide. It was also agreed that such guidance was extremely important and urgent to all States at a time of economic crisis but in particular to States with developing economies and economies in transition. In addition, it was stated that the scope of the draft Model Law should include all economically valuable assets.[28] The Commission also agreed that whether that work would include security interests in non-intermediated securities would be assessed at a future time.[29]

30. The Working Group continued its work at its twenty-fourth session, in 2013, and at its twenty-fifth session, in 2014, on the basis of notes prepared by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.57 and Add.1-4, and A/CN.9/WG.VI/WP.59 and Add.1). The reports of the Working Group on its work at those sessions are contained in documents A/CN.9/796 and A/CN.9/802. At its twenty-fifth session, the Working Group also decided to recommend to the Commission that the draft Model Law address security rights in non-intermediated securities (see A/CN.9/802, para. 93).

31. At its forty-seventh session, in 2014, the Commission expressed its satisfaction for the considerable progress achieved by the Working Group in its work and requested the Working Group to expedite its work so as to complete the draft Model Law, including certain definitions and provisions on non-intermediated

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[26] Ibid., paras. 102 and 103.
[27] Ibid., para. 104.
[28] Ibid., *Sixty-eighth Session, Supplement No. 17* (A/68/17), para. 193.
[29] Ibid., para. 332.

securities (see A/CN.9/811), and to submit it to the Commission for adoption together with a guide to enactment as soon as possible.[30]

32. The Working Group continued its work at its twenty-sixth session, in 2014, and at its twenty-seventh session, in 2015, on the basis of notes prepared by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.61 and Add.1-3, and A/CN.9/WG.VI/WP.63 and Add.1-4). The reports of the Working Group on its work at those sessions are contained in documents A/CN.9/830 and A/CN.9/836.

33. At its forty-eighth session, in 2015, the Commission considered and approved the substance of article 26 of chapter IV of the Model Law and articles 1-29 of the draft Registry Act.[31] At that session, the Commission also agreed that a guide to enactment of the Model Law should be prepared and referred that task to the Working Group.[32]

34. The Working Group continued its work at its twenty-eighth session, in 2015, and completed it at its twenty-ninth session, in 2016, on the basis of notes prepared by the Secretariat entitled "Draft Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.65 and Add. 1-4) and "Draft Guide to Enactment" (A/CN.9/WG.VI/WP.66 and Add. 1-4). The reports of the Working Group on its work at those sessions are contained in documents […].

35. In preparation for the forty-ninth session of the Commission, the text of the draft Model Law as approved by Working Group VI was circulated to all Governments and to interested international organizations for comment. At that session, the Commission had before it the reports of the Working Group on its twenty-eighth and twenty-ninth sessions, the comments received from Governments (A/CN.9/[…]), as well as the Model Law and the draft Guide to Enactment prepared by the Secretariat (A/CN.9/[…]). At that session, the Commission […].

36. After consideration of the Model Law and the draft Guide to Enactment, the Commission adopted the following decision:

[…].

III. The Model Law as a tool for harmonizing laws

37. The Model Law is in the form of a legislative text that is recommended to States for incorporation into their national law. Unlike an international convention, model legislation does not require the State enacting it to notify the United Nations or other States that may have also enacted it. However, States are strongly encouraged to inform the UNCITRAL secretariat of any enactment of the new Model Law (or any other model law resulting from the work of UNCITRAL).

38. In incorporating the text of model legislation into its legal system, a State may wish to consider modifying or leaving out some of its non-fundamental provisions.

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[30] Ibid., *Sixty-ninth Session, Supplement No. 17* (A/69/17), para. 163.
[31] Ibid., *Seventieth Session, Supplement No. 17* (A/70/17), para. 214.
[32] Ibid., para. 216.

In the case of a convention, the possibility of changes being made to the uniform text by the States parties (normally referred to as "declarations") is much more restricted; trade law conventions in particular usually either totally prohibit declarations or allow only very few, specified ones. The flexibility inherent in model legislation is particularly desirable in those cases where it is likely that the State would wish to make various modifications to the uniform text before it would be ready to enact it as national law. Some modifications may be expected, in particular when the uniform text is closely related to the national court and procedural system. This, however, also means that the degree of, and certainty about, harmonization achieved through model legislation is likely to be lower than in the case of a convention.

39. However, this relative disadvantage of model legislation may be balanced by the fact that the number of States enacting model legislation is likely to be higher than the number of States adhering to a convention. In order to achieve a satisfactory degree of harmonization and certainty, it is recommended that States make as few changes as possible in incorporating the new Model Law into their legal systems and that they take due regard of its basic principles, including the unitary and functional approach to secured transactions, party autonomy and the international origin of the Model Law. In general, in enacting the Model Law, it is advisable to adhere as much as possible to the uniform text in order to make the national law as transparent and familiar as possible for foreign users of the national law. The Model Law is sufficiently flexible in providing options and leaving a number of matters to States.

40. While it is recommended that the Model Law should be implemented in one law, depending on its legal tradition and drafting conventions, the enacting State may implement the registry-related provisions in its secured transactions law, or in another law, decree, regulation or another act adopted by a legislative or executive body, or in a combination thereof. Similarly, the conflict-of-laws provisions may be incorporated in the secured transactions law (at the beginning or at the end of it) or in a separate law (civil code or other law).

IV. Main features of the Model Law

A. Relationship of the Model Law with the secured transactions texts of UNCITRAL

41. The Secured Transactions Guide, including the Intellectual Property Supplement, and the Registry Guide contain detailed commentary and recommendations on all issues to be addressed in a modern law on secured transactions. However, they are long texts and States will need assistance in implementing their recommendations. Thus, the Model Law was prepared to complement those texts and to assist States in implementing their recommendations.

42. The Model Law reflects the policies embodied in the recommendations of those texts. The difference in the formulation between a provision of the Model Law and the relevant recommendation is due to the legislative nature of the Model Law. Where there is a difference, it is explained in the remarks to the relevant provision of the Model Law below.

43. For reasons explained below, the Model Law also addresses matters that were not addressed in the Secured Transactions Guide (e.g. security rights in non-intermediated securities) or were not addressed in a recommendation of the Registry Guide (e.g. the effectiveness of amendment or cancellation notices that have not been authorized by the secured creditor). At the same time, the Model Law does not address matters that were addressed in the Secured Transactions Guide (e.g. security rights in the right to receive the proceeds under an independent undertaking).

B. Key objectives and fundamental policies of the Model Law

44. The overall objective of the Model Law is the same as that of the Secured Transactions Guide, that is, to promote low-cost credit by enhancing the availability of secured credit (see rec. 1 and Introduction, paras. 43-59). The fundamental policies of the Model Law are the same as those of the Secured Transactions Guide (see Introduction, paras. 60-72). In enacting the Model Law, States may wish to consider issues of harmonization with existing law, legislative method, drafting technique and post-enactment acculturation (see Introduction, paras. 73-89).

45. Depending on its drafting method and technique, the enacting State may wish to consider including the key objectives of the Model Law in a preamble or other statement of objectives of the law. That statement could be used for the purpose of the interpretation of, and the filling of gaps in, the Model Law.

[*Note to the Working Group: The Working Group may wish to consider the suggestion made in the note to article 5 about a new rule on the interpretation of the Model Law.*]

V. Assistance from the UNCITRAL secretariat

A. Assistance in drafting legislation

46. In the context of its training and assistance activities, the UNCITRAL secretariat assists States with technical consultations for the preparation of legislation based on the Model Law. The same assistance is brought to Governments considering legislation based on other UNCITRAL model laws (i.e. the UNCITRAL Model Law on Cross-Border Insolvency, the UNCITRAL Model Law on International Commercial Arbitration, the UNCITRAL Model Law on International Commercial Conciliation, the UNCITRAL Model Law on Electronic Commerce, the UNCITRAL Model Law on Electronic Signatures, the UNCITRAL Model Law on International Credit Transfers and the UNCITRAL Model Law on Public Procurement) or considering adhesion to one of the international trade law conventions prepared by UNCITRAL (e.g. the Assignment Convention).

47. Further information concerning the Model Law and other model laws and conventions developed by UNCITRAL, may be obtained from the UNCITRAL secretariat at the address below:

International Trade Law Division, Office of Legal Affairs
United Nations
Vienna International Centre

P.O. Box 500
A-1400 Vienna, Austria
Telephone: (+43-1) 26060-4060 or 4061
Telecopy: (+43-1) 26060-5813
Electronic mail: uncitral@uncitral.org
Internet home page: www.uncitral.org

B. Information on the interpretation of legislation based on the Model Law

48. The UNCITRAL secretariat welcomes comments concerning the Model Law and the Guide, as well as information concerning enactment of legislation based on the Model Law. Once enacted, the Model Law will be included in the CLOUT information system, which is used for collecting and disseminating information on case law relating to the conventions and model laws that have emanated from the work of UNCITRAL. The purpose of the system is to promote international awareness of the legislative texts formulated by UNCITRAL and to facilitate their uniform interpretation and application. The UNCITRAL secretariat publishes, in the six official languages of the United Nations, abstracts of decisions and arbitral awards. In addition, upon individual request and subject to any copyright and confidentiality restrictions, the UNCITRAL secretariat makes available to the public all decisions and arbitral awards on the basis of which the abstracts were prepared. The system is explained in a user's guide that is available from the UNCITRAL secretariat in hard copy (A/CN.9/SER.C/GUIDE/1/Rev.2) and on the above-mentioned Internet home page of UNCITRAL.

VI. Article-by-article remarks

Chapter I. Scope of application and general provisions

Article 1. Scope of application

49. Article 1 is based on recommendations 1-7 of the Secured Transactions Guide (see chap. I, paras. 1-4). It is intended to set out the various types of transaction and asset covered by the Model Law (see art. 1, paras. 1-4), as well as to clarify the relationship between the Model Law and other law (see art. 1, paras. 5 and 6). Generally, the Model Law has the same comprehensive scope of application as the Secured Transactions Guide and applies to all property rights in any type of movable asset, such as equipment, inventory and receivables, which is created by an agreement to secure payment or other performance of an obligation (see art. 1, para. 1, and definition of the term "security right" in art. 2, subpara. (jj)). However, there are a few differences between the scope of the Model Law and the scope of the Secured Transactions Guide.

50. Like the Secured Transactions Guide, the Model Law applies to outright transfers of receivables (see art. 1, para. 2). The main reasons for this approach are that outright transfers of receivables take place in the context of financing transactions and it is difficult to determine at the outset of a transaction whether an assignment will be held to be an outright or a security assignment (see Secured

Transactions Guide, Chap. I, paras. 25-31). [However, unlike the Secured Transactions Guide, the Model Law excludes from its scope certain types of outright transfers of receivables.]

[*Note to the Working Group: Depending on the decision of the Working Group, this paragraph may need to be deleted or revised to refer to the relevant reasons for the exclusion of certain types of outright transfer of receivables (see art. 1, Note to the Working Group).*]

51. In addition, unlike the Secured Transactions Guide, the Model Law excludes from its scope security rights in the right to receive the proceeds under an independent undertaking (see art. 1, subpara. 3(a)). The reason is that financing practices relating to independent undertakings are subject to special rules. In any case, States interested in addressing those practices in their general secured transactions law can always implement the relevant recommendations of the Secured Transactions Guide (recs. 27, 50, 107, 127, 176 and 212).

52. Moreover, unlike the Secured Transactions Guide, the limitation as to the application of the Model Law to security rights in intellectual property (see art. 1, subpara. 3(b)) may not be necessary if the enacting State has already coordinated or otherwise addressed the relationship between the Model Law and its law relating to intellectual property.

53. Also, unlike the Secured Transactions Guide, the Model Law does not exclude from its scope security rights in non-intermediated securities (see art. 1, subpara. 3(c)). The reason is that such securities are part of commercial finance transactions and are not addressed in any other international trade law text.

54. [Finally, the Model Law excludes payment rights under or from financial contracts governed by "close-out netting agreements", rather than "netting agreements", to ensure that transactions relating to set off [even between two sellers of goods with trade claims] and counter-claims would not be inadvertently excluded (see art. 1, subpara. 3(d)).]

[*Note to the Working Group: The Working Group may wish to note that the bracketed text may have to be deleted or revised, depending on its decision with respect to the bracketed words in article 1, subparagraph 3(d) (see Note to the Working Group).*]

55. While consistent with the policy of recommendation 7 of the Secured Transactions Guide, subparagraph 3(f), adds a condition to further exclusions, that is, that other law governs matters addressed in the Model Law. The reason for this approach is to avoid inadvertently creating gaps in the law. In addition, subparagraph 3(f), provides guidance to States as to possible exclusions, referring to types of asset, such as ships and aircraft, that are subject to specialized secured transactions and asset-based registration regimes.

56. Similarly, while paragraph 4, is formulated somehow differently from recommendation 6 of the Secured Transactions Guide, there is no policy difference between the two rules. The policy may be explained as follows. In the case of a security right in an asset covered by the Model Law, the security right extends to its identifiable proceeds (see art. 10, para. 1). This rule applies even if the proceeds are of a type that is outside the scope of the Model Law (such as intermediated securities) except if a security right in those securities is subject to other law.

57. Paragraph 5, which is a reformulation of the rule in recommendation 2, subparagraph (b), of the Secured Transactions Guide, is intended to preserve the application of consumer protection law. For example, under consumer-protection law, it may not be possible to create a security right in all present and future assets, employment benefits, at least up to a certain amount, or necessary household items of a consumer. Enacting States that do not have a developed consumer-protection law may need to consider whether enactment of the Model Law should be accompanied by the enactment of such special protections for consumers. It should also be noted that the Model Law already includes certain consumer-specific rules. For example, under article 22, an acquisition security right in consumer goods is effective against third parties upon its creation.

58. In line with recommendation 18 of the Secured Transactions Guide, paragraph 6 is intended to preserve limitations to the creation or the enforceability of a security right in certain types of asset (such as employment benefits) that are based on other law (statutory or case law), if any. At the same time, it is intended to ensure that such limitations based on the sole ground that an asset is a future asset or a part or undivided interest in an asset are overridden (see art. 8, paras. (a) and (b)). However, paragraph 6 does not apply to contractual limitations (negative pledge agreements). The Model Law overrides explicitly contractual limitations with respect to receivables or other intangible assets, negotiable instruments or rights to payment of funds credited to a bank account (see art. 12). With respect to other types of asset, contractual limitations are overridden implicitly to the extent that the Model Law allows the owner of an asset to create a security right in that asset, even if the security or other agreement expressly restricts that right. The Model Law does not condition the creation, third-party effectiveness or priority of a security right in an asset on the grantor having the right to encumber it (art. 6, para. 1, refers only to the "power to encumber").

59. Finally, unlike the Secured Transactions Guide, the Model Law does not apply to attachments to movable assets or immovable property. Thus, the Model Law does not include a provision along the lines of recommendation 5, which provides that, while the law recommended in the Secured Transactions Guide does not apply to immovable property, it does apply to attachments to immovable property. Enacting States are encouraged to include in their enactments of the Model Law provisions based on the relevant recommendations of the Secured Transactions Guide (see recs. 21, 25, 43, 48, 87, 88, 164, 165, 184, 195 and 196).

Article 2. Definitions and rules of interpretation

60. Article 2 explains the meaning of most key terms used in the Model Law. The meaning of other terms is explained in various articles of the Model Law. For example: (a) the meaning of the term "registry" is explained in article 26; and (b) the meaning of the term "default" is explained in article 66, paragraph 1. Article 2 is based on the terminology and rules of interpretation of the Secured Transactions Guide (see Introduction, paras. 15-20). Rules of interpretation include the following: (a) the word "or" is not intended to be exclusive; (b) the singular includes the plural and vice versa; and (c) the words "include" or "including" are not intended to indicate an exhaustive list (see Introduction, para. 17).

Acquisition security right

61. An acquisition security right is a security right that secures the grantor's obligation with respect to credit provided to enable the grantor to acquire a tangible asset (other than reified intangible assets), intellectual property and the rights of a licensee in intellectual property. Where a security right secures obligations in addition to the credit extended and used for the purpose of acquiring the encumbered asset, it is an ordinary security right to the extent of those additional obligations.

Bank account

62. To underline the distinction between a "bank account" and a "securities account", the Model Law defines the latter term as "an account maintained by an intermediary to whom securities may be credited or debited" and the term "securities" in a manner that clearly excludes funds. The term "bank account" includes a checking or other current account, as well as a savings or deposit account. The enacting State may wish to consider including a definition of the term "bank" in its secured transactions law or rely for this purpose on other law.

Certificated non-intermediated securities

63. The term "represented" is broad enough to cover the approaches taken in different jurisdictions (e.g. "covered" or "embodied"). The term "certificate" means only a tangible document subject to physical possession. Thus, securities represented by an electronic certificate are uncertificated securities under the Model Law.

Control agreement

64. While the effect of a control agreement is to render a security right effective against third parties (see art. 16), its purpose is to ensure the cooperation of the depositary bank or the issuer in the enforcement of a security right. Unlike the definition of this term in the Secured Transactions Guide, on which this definition is based, this definition does not refer to a "signed writing". This difference does not reflect a policy change but rather a decision that this matter should be left to the authorization requirements of the enacting State. A control agreement does not need to be in a single writing. It should be noted that any reference to a "writing" in the Model Law is intended to cover electronic equivalents (see Secured Transactions Guide, recs. 11 and 12).

Money

65. The term "money", whose definition is based on a definition contained in the Secured Transactions Guide, is intended to include not only the national currency (i.e. banknotes and coins) of the enacting State but also foreign currency. [No reference is made to currency "currently" authorized as a legal tender, because if currency is not "currently" authorized as a legal tender, it would not qualify as a legal tender.] Rights to payment of funds credited to a bank account and negotiable instruments are recognized as distinct concepts in the Model Law and they are not included in the term "money".

Non-intermediated securities

66. The term "non-intermediated securities" includes shares and bonds that are not held in a securities account. The term does not include the rights of an intermediary or a competing claimant in securities held by the intermediary directly against the issuer because those securities are credited by the intermediary to a securities account in the name of the grantor and therefore qualify as intermediated securities for the purposes of that transaction.

Notification of a security right in a receivable

67. The requirement for the identification of the encumbered receivable and the secured creditor that was included in the definition of this term in the Secured Transactions Guide was moved to article 56, paragraph 1, as it states a substantive rule on the effectiveness of a notification of a security right, a matter that is already addressed in article 56, paragraph 1.

Proceeds

68. The term "proceeds" has the same meaning as in the Secured Transactions Guide. It is important to note that it covers both proceeds of the sale of an encumbered asset by the grantor or a person that acquired the asset from the grantor and natural or civil fruits. The terms revenues, dividends and distributions, which were included in the definition of this term in the Secured Transactions Guide, have been deleted on the understanding that they are covered by the term "civil fruits".

Receivable

69. Like the Secured Transactions Guide, the Model Law defines the term "receivable" in a broad way to cover even non-contractual receivables (e.g. tort receivables). To the contrary, in the Assignment Convention, the term "receivable" is limited to contractual rights to payment.

Secured obligation

70. The term "secured obligation" includes any obligation secured by a security right, including credit extended to cover the operational costs of a business or to pay the purchase price of goods. It includes not only obligations already incurred at the time of the extension of the credit but also obligations incurred thereafter, if the security agreement so provides. As in other UNCITRAL texts, in the Model Law the singular includes the plural and vice versa (see para. 60 above). So, for example, a reference to the secured obligation would be sufficient to cover all present and future secured obligations.

Securities

71. The definition of the term "securities" is narrower than the definition of that term in article 1, subparagraph (a), of the Unidroit Securities Convention. The reason is that, while a broad definition is appropriate for the purposes of that Convention, it is overly broad for the purposes of the Model Law and could result in subjecting security rights in receivables, negotiable instruments, money and other generic intangible obligations to the special rules applicable to security rights in non-intermediated securities (see A/CN.9/802, para. 74). In any case, each enacting

State would need to coordinate the definition of the term "securities" in its secured transactions law with the definition of this term in its securities transfer law.

Securities account

72. The definition of this term is derived from article 1, subparagraph (c), of the Unidroit Securities Convention.

Tangible asset

73. The term "tangible asset" includes the terms consumer goods, equipment and inventory, terms that do not refer to subcategories of tangible assets but rather to the way in which particular tangible assets are used by the grantor. Thus, the same cars could qualify as "consumer goods", if it is used by the grantor for personal purposes, as "equipment", if it is used by the grantor in its business, or as "inventory", if the grantor happens to be a car dealer or manufacturer.

Article 3. International obligations of this State

74. Article 3 is based on article 3 of the UNCITRAL Model Law on Cross-Border Insolvency. It is intended to reflect the principle of the prevalence of international treaties (such as the Convention on International Interests in Mobile Equipment and its Protocols) over domestic law.

Article 4. Party autonomy

75. Article 4 is based on article 6 of the Assignment Convention (the first sentence of which is based on art. 6 of the United Nations Convention on Contracts for the International Sale of Goods ("CISG")) and recommendation 10 of the Secured Transactions Guide. It is intended to reflect the principle that, with certain exceptions stated in the Model Law, parties are free to vary its effect as between them.

76. An agreement referred to in paragraph 1 may be not only between the secured creditor and the grantor but also between the secured creditor or the grantor and other parties whose rights may be affected by the Model Law, such as the debtor of an encumbered receivable, or between the secured creditor and a competing claimant. [Paragraph 2 is intended to clarify that, while an agreement between two parties may benefit a third party, it cannot negatively affect its rights.]

[*Note to the Working Group: Depending on the decision of the Working Group with respect to the bracketed words in paragraph 2, the bracketed text in this paragraph my need to be revised.*]

Article 5. General standards of conduct

77. Article 5 is based on recommendation 132 of the Secured Transactions Guide (see chap. VII, para. 15). Under paragraph 1, any person must exercise all its rights and perform all its obligations under the Model Law (and not only the rights and obligations under the provisions of the enforcement chapter) in good faith and in a commercially reasonable manner. The violation of this obligation may result in liability to damages and other consequences that are left to the relevant law of the enacting State.

78. The concept of "commercial reasonableness" refers to the commercial transaction context and best practices. Meeting the specific standards referred to in other articles of the Model Law (e.g. art. 72, para. 4, according to which notice is to be given within a short period of time) should generally be construed as meeting the general standards of conduct referred to in this article.

79. To protect the legitimate interests of all parties and avoid abuses, subparagraph 2(a) provides that the duty to act in good faith and in a commercially reasonable manner cannot be waived or varied by agreement. Under subparagraph 2(b), this duty does not apply to an outright transfer without recourse. The reason is that the grantor (transferor) has no remaining vested interest in the receivable that could be protected by a limitation on the way in which the secured creditor (transferee) could collect the receivable.

Chapter II. Creation of a security right

A. General rules

Article 6. Security agreement

80. Article 6 is based on recommendations 13-15 of the Secured Transactions Guide (see chap. II, paras. 12-37). Its purpose is to deal with the creation of a security right, and the form and the minimum content of a security agreement so as to achieve one of the key objectives of an effective and efficient secured transactions law, that is, to enable parties to create a security right in a simple and efficient manner (see Secured Transactions, rec. 1, subpara. (c)).

81. Thus, under paragraph 1, an agreement that meets the requirements of paragraphs 2 to 5 is sufficient to create a security right even in future assets (produced or acquired by the grantor after the conclusion of the security agreement; see definition in art. 2, subpara. (m)). Paragraph 2 clarifies that, in the case of future assets, the security right is created when the grantor acquires rights in them or the power to encumber them.

82. Depending on what it considers as most efficient financing practices and on the assumptions of market participants, the enacting State may wish to consider whether to retain subparagraph 3(e). One approach is to retain subparagraph 3(e) to facilitate the grantor's access to secured financing from other creditors in situations where the value of the assets encumbered by the prior registered security right exceeds the maximum amount indicated in the notice. Another approach is to leave out subparagraph 3(e) to facilitate the grantor's access to credit by the first-registered secured creditor (for the comparative advantages and disadvantages of the two approaches, see Secured Transactions Guide, chap. IV, paras. 92-97).

83. The enacting State may wish to select in paragraph 4 one of the two alterative wordings that are set out within square brackets that is most fitting to its contract law. If the enacting State retains the words "concluded in", a security agreement that is not in written form is not effective. If the enacting State retains the words "evidenced in", a security agreement that is not in written form is in principle effective but its existence may only be evidenced by a writing.

Article 7. Obligations that may be secured

84. Article 7 is based on recommendation 16 of the Secured Transactions Guide (see chap. II, paras. 38-48). It is primarily intended to ensure that future, conditional and fluctuating obligations may be secured (see Secured Transactions Guide, chap. II, paras. 38-48). The main reason for this approach is to facilitate modern financing transactions, in the context of which disbursements are made at different times depending on the needs of the grantor (e.g. revolving credit facilities for the grantor to buy inventory). This approach does not preclude the introduction of special protections for grantors (e.g. setting a maximum amount for which the security right may be enforced; see art. 6, subpara. 3(e)).

Article 8. Assets that may be encumbered

85. Article 8 is based on recommendation 17 of the Secured Transactions Guide (see chap. II, paras. 49-57 and 61-71). It is primarily intended to ensure that future movable assets, parts of and undivided rights in movable assets, generic categories of movable assets, as well as all movable assets of a person, may become the subject of a security right.

86. It should be noted that the fact that future movable assets may be subject to a security right does not mean that statutory limitations to the creation or enforcement of a security right in specific types of asset (e.g. employment benefits in general or up to an amount) are overridden (see art. 1, para. 6).

87. It should also be noted that the fact that all movable assets of a grantor may be subject to a security right so as to maximize the credit that may be available and improve the terms of the credit agreement does not mean that other creditors of the grantor are necessarily unprotected. The protection of other creditors (within and outside insolvency proceedings) is a matter of other law and is foreseen in article 32.

Article 9. Description of encumbered assets

88. Article 9 is based on recommendation 14, subparagraph (d), of the Secured Transactions Guide (see chap. II, paras. 58-60). In view of their importance, the requirements for the description of encumbered assets in a security agreement are presented in a separate article. Article 9 is intended to ensure that a security right may be created in an asset or class of assets even if the description in the security agreement is generic, such as “all inventory” or “all receivables” (see Secured Transactions Guide, chap. II, paras. 58-60).

Article 10. Proceeds and proceeds in the form of funds commingled with other funds

89. Article 10 is based on recommendations 19 and 20 of the Secured Transactions Guide (see chap. II, paras. 72-89). Paragraph 1 is intended to ensure that, unless otherwise agreed by the parties, a security right in an asset automatically extends to its identifiable proceeds (see para. 1). The rationale for this rule is that it reflects the normal expectations of the parties and ensures that the secured creditor is sufficiently secured. This is important as other parties may have a security right in assets that are proceeds of other assets (e.g. in the receivables generated from the

sale of encumbered inventory) and the rights of all competing creditors should be clearly defined and addressed in the same law.

90. Here is an example of a typical transaction that highlights the importance of proceeds: where the original encumbered asset is inventory, the receivables generated from the sale of the inventory are proceeds. If upon payment of the receivables the money is deposited in a bank account, the right to payment of the funds credited to the bank account are also proceeds of the inventory. If a check is issued out of the bank account for the purchase of new inventory, the check is also part of the proceeds of the inventory. So is new inventory purchased, as well as any warehouse receipt if the new inventory is placed in a warehouse.

91. Paragraph 2 introduces an exception to the rule in paragraph 1. Even though they are not identifiable, the security right in an asset extends to its proceeds in the form of funds that are commingled with other funds.

92. Paragraph 3 limits that security right to the value of the proceeds immediately before they were commingled. So, if a sum of €1,000.00 is deposited in a bank account and at the time of enforcement the bank account has a balance of €2,500.00, the security right extends to the sum of €1,000.00.

93. Paragraph 4 deals with the situation in which the balance in the bank account is less than the value of the proceeds deposited (i.e. less than €1,000.00). In such a case, under paragraph 4, the security right extends to the lowest value between the time when the proceeds were commingled and the time the security right in the proceeds is claimed. So, if in the example given, the balance in the account where the proceeds were deposited was €1,500.00, then it went down to €500.00 and at the time of enforcement was €750.00, the security right extends to €500.00 (i.e. the lowest intermediate balance).

Article 11. Tangible assets commingled in a mass or product

94. Article 11 is based on recommendations 22 and 91 of the Secured Transactions Guide (see chap. II, paras. 90-95 and 100-102, and chap. V, paras. 117-123). Paragraph 1 is intended to ensure that a security right in assets commingled in a mass or product, even though they are no longer identifiable, continues in the mass or product.

95. Under paragraph 2, the security right is limited to the value [of the mass in the same proportion as the encumbered assets and the assets not encumbered contributed to the value of the mass] [the quantity of the encumbered asset that became part of the mass]. So, [if a secured creditor has a security right in €100,000.00 worth of oil that is commingled with €50,000.00 worth of oil in the same tank and thus the mass has €150,000.00 worth of oil, the security right is deemed to encumber two thirds of whatever oil remains in the tank at the time it becomes necessary to enforce the security right (even if the price of the oil goes up or down)] [if: (a) a security right is created in 100,000 litres of oil to secure an obligation of €100,000.00 (€1 per litre) and the security agreement and the notice describe the encumbered assets accordingly; (b) the 100,000 litres of oil are commingled with another 50,000 litres of oil in a tank and become part of a mass; and (c) at the time of enforcement, the value of the mass (150,000 litres of oil) is only €75,000.00 because of a drop on oil prices (€0.5 per litre), the secured creditor

should be able to enforce its security right against 100,000 litres of oil worth only €50,000.00)].

96. Paragraph 3 contains a different rule with respect to tangible assets commingled in a product (e.g. flour commingled in bread). Under paragraph 3, the security right in the product is limited to the value of the encumbered asset immediately before they became part of the product. So, if encumbered flour worth €100.00 is commingled and bread worth €500.00 is produced, the security right is limited to €100.00.

97. It should be noted that the word "limited" in paragraphs 2 and 3 means that, if the value of the encumbered asset commingled in the mass or product increases after commingling, the increased value is unencumbered. In other words, the secured creditor does not benefit from commodity price increases (see Secured Transactions Guide, chap. V, para. 118 ad finem). Similarly, the word "limited" does not address the question of what is the amount secured if the price of the encumbered asset decreases after commingling. The rule applicable to all types of encumbered asset applies to tangible assets commingled in a mass or product, namely that each party bears the risk of decreases of the price of the encumbered asset.

[*Note to the Working Group: Depending on the decisions of the Working Group, the commentary to paragraphs 2 and 3 may need to be revised. The commentary to 4, which appears within square brackets, will be prepared after the Working Group has decided whether it should be retained.*]

Article 11bis. Extinction of a security right

98. Article 11bis deals with the extinction of a security right by full payment or other satisfaction of all secured obligations, including future obligations based on an existing commitment of the secured creditor to extend credit. Reference to the extinction of a security right is made in articles 49 (obligation of a secured creditor to return an encumbered asset), and article 21, subparagraph 2(c) of the registry-related provisions (compulsory registration of an amendment or cancellation notice).

B. Asset-specific rules

Article 12. Contractual limitations on the creation of a security right

99. Article 12 is based on recommendation 24 of the Secured Transactions Guide (see chap. II, paras. 106-110 and 113), which in turn is based on article 9 of the Assignment Convention. It is intended to ensure that an agreement limiting the grantor's right to create a security right in the types of assets listed in this article does not invalidate a security right created in violation of such an agreement. The rationale underlying this approach is to facilitate the use of receivables as security for credit, which is in the interest of the economy as a whole, without unduly interfering with party autonomy.

100. Compared with recommendation 24 of the Secured Transactions Guide, article 12 has been revised to address contractual limitations on the creation of a security right in assets in addition to receivables, namely other intangible assets,

negotiable instruments and rights to payment of funds credited to a bank account (see A/CN.9/830, paras. 59-63).

101. Paragraph 2 limits the impact of the rule in paragraph 1. Under paragraph 2, if the debtor of the receivable has sufficient negotiating power to force the grantor to accept the inclusion of a "no-assignment clause" in their agreement and a breach of that agreement by the grantor results in a loss to the debtor of the receivable, the grantor is liable to damages under contract law. However, the debtor of the receivable may not avoid the contract because of that breach or raise against the secured creditor (assignee) any claim it may have against the grantor for that breach. In addition, under paragraph 3, a secured creditor that accepts a receivable as security for credit is not liable for the grantor's breach just because it had knowledge of the "no-assignment clause".

102. As a result of the rules in paragraphs 1-3, a secured creditor does not have to check each contract from which a receivable might arise to determine whether it contains a no assignment clause. This facilitates secured transactions in which security is created in bulk receivables and transactions in which future receivables are involved.

103. Paragraph 4 limits the scope of the rule in paragraph 1 to broadly defined trade receivables. It does not apply to so-called "financial receivables", because, where the debtor of the receivable is a financial institution, even partial invalidation of an anti-assignment clause could affect obligations undertaken by the financial institution towards third parties (see Secured Transactions Guide, para. 108).

104. Read together with article 6, paragraph 1, article 24 does not override statutory limitations to the creation or enforcement of a security right in certain types of receivable (e.g. sovereign receivables).

Article 13. Personal or property rights securing or supporting payment or other performance of an encumbered receivable or other intangible asset, or negotiable instrument

105. Option A of paragraphs 1 and 2 reflects the thrust of recommendation 25 of the Secured Transactions Guide (see chap. II, paras. 111-122), while option B reflects the thrust of article 10 of the Assignment Convention.

106. Under option A, a security right in a receivable or another of the assets described in paragraph 1 automatically extends to any personal right that supports payment or other performance of the receivable (e.g. guarantee) and any property right that secures such payment or other performance (e.g. a security right in another asset). To avoid interfering with the rights of a guarantor, issuer, confirmer or nominated person of an independent undertaking, where the supporting right is an independent undertaking, the security right extends only to the right to receive the proceeds and not to the right to demand payment under the independent undertaking.

107. Under option B, the security right extends automatically to accessory security or supporting rights, while with respect to independent rights, the grantor is obliged to create a security right in them in favour of the secured creditor. Thus, there is no inconsistency with article 1, subparagraph 3(a), and there is no need to also include the full text of recommendation 127 of the Secured Transactions Guide to protect

the rights of a guarantor/issuer, confirmer or nominated person of an independent undertaking.

[*Note to the Working Group: If the Working Group retains option A, to avoid any adverse impact on the rights of a guarantor/issuer, confirmer or nominated person of an independent undertaking, the thrust of recommendation 127 of the Secured Transactions Guide should also be included in the Model Law.*]

Article 14. Negotiable documents and tangible assets covered

108. Article 14 is based on recommendation 28 of the Secured Transactions Guide (see chap. II, para. 128). It is intended to ensure that a security right in a negotiable document extends to the tangible assets covered by the document, if the issuer is in possession of the assets when the document is issued (e.g. inventory or crops deposited in a warehouse for which the warehouse operator issued a negotiable warehouse receipt).

109. In view of the definition of the term "possession" in article 2, subparagraph (z), possession of the issuer of a negotiable document includes possession by its representative or a person acting on behalf of the issuer. A security right in a negotiable document extends to the tangible assets covered by the document and will continue to exist even after the document no longer covers the assets. However, effectiveness against third parties through possession of the document applies only as long as the document covers the assets and lapses once they are released by the issuer (see article 24, para. 2).

Article 15. Tangible assets with respect to which intellectual property is used

110. Article 15 is based on recommendation 243 of the Intellectual Property Supplement (see paras. 108-112). It is intended to ensure that, unless otherwise agreed, a security right in a tangible asset does not automatically extend to the intellectual property right contained therein, and that a security right in an intellectual property right does not automatically extend to the tangible asset with respect to which the intellectual property right is used (e.g. the copyrighted software included in a personal computer or the trademark on an inventory of clothes).

Chapter III. Effectiveness of a security right against third parties

A. General rules

Article 16. General methods for achieving third-party effectiveness

111. Article 16 is based on recommendation 32 of the Secured Transactions Guide (see chap. III, paras. 19-86). It is intended to set out general methods for achieving third-party effectiveness (i.e. registration in the general security rights registry, a specialized registry or title certificate, and possession of the encumbered asset by the secured creditor). Other methods (e.g. control) are set out in the asset-specific provisions of this chapter.

Article 17. Proceeds

112. Article 17 is based on recommendations 39 and 40 of the Secured Transactions Guide (see chap. III, paras. 87-96). It is intended to determine the circumstances in which the security right in proceeds that is provided for in article 10 will be effective against third parties.

113. Under paragraph 1 a security right in cash proceeds (i.e. money, receivables, negotiable instruments or rights to payment of funds credited to a bank account) is automatically effective against third parties. For example, upon the sale of encumbered inventory, the receivable, cash, bank deposit, check and new inventory generated are proceeds of the originally encumbered inventory.

114. Unlike recommendation 39, on which this article is based, paragraph 1 does not refer to the description of the proceeds in the notice. This change is a drafting change and does not constitute a change of policy. The reason for this change is that, once the proceeds are described in the notice (in line with the security agreement), they constitute original encumbered assets, not proceeds, and article 16 is sufficient in dealing with the third-party effectiveness of a security right in those assets.

115. Under paragraph 2, if a security right in an asset is effective against third parties, the security right in their proceeds is effective against third parties for a short period of time and thereafter only, if before the expiry of that short period, the security right in the proceeds is made effective against third parties by one of the methods set out in article 16 or the asset-specific provisions of this chapter.

Article 18. Changes in the method for achieving third-party effectiveness

116. Article 18 is based on recommendation 46 of the Secured Transactions Guide (see chap. III, paras. 120 and 121). It is intended to ensure that a security right made effective against third parties by one method may later be made effective by another method, and that third-party effectiveness is continuous as long as there is no lapse in third-party effectiveness.

Article 19. Lapse in third-party effectiveness

117. Article 19 is based on recommendation 47 of the Secured Transactions Guide (see chap. III, paras. 122-127). It is intended to ensure that, if third-party effectiveness lapses, it may be re-established, but third-party effectiveness dates as of the time it is re-established.

Article 20. Impact of a transfer of an encumbered asset

118. Article 20 has a twofold purpose; first, to reflect the generally accepted rule that a security right follows an encumbered asset in the hands of a transferee (droit de suite); and second, to provide that, unless otherwise provided in article 27 [of the registry-related provisions], that security right is also automatically effective against third parties.

Article 21. Continuity in third-party effectiveness upon a change of the applicable law to this Law

119. Article 21 is based on recommendation 45 of the Secured Transactions Guide (see chap. III, paras. 117-119). Under paragraph 1, if the Model Law becomes

applicable as a result, for example, of a change in the location of the encumbered asset or the grantor, a security right that was effective against third parties under the previously applicable law remains effective against third parties under the Model Law for a short period of time. Thereafter, the security right is effective only if, before the expiry of that period, it is made effective against third parties under the relevant provisions of the Model Law. Under paragraph 2, if the third-party effectiveness of a security right does not lapse, it dates back to the time it was first achieved under the previously applicable law.

Article 22. Acquisition security rights in consumer goods

120. Article 22 is based on recommendation 179 of the Secured Transactions Guide (see chap. IX, paras. 125-128). While an acquisition security right in consumer goods is automatically effective against third parties, it does not have the special priority of an acquisition security right over a security right registered in a specialized registry (see article 30).

B. Asset-specific rules

Article 23. Rights to payment of funds credited to a bank account

121. Article 23 is based on recommendation 49 of the Secured Transactions Guide (see chap. III, paras. 138-148). It adds three new methods of achieving third-party effectiveness of a security right in a right to payment of funds credited to a bank account (i.e. the creation of the security right in favour of the depositary bank, the conclusion of a control agreement and any action necessary for the secured creditor to become the account holder). The exact nature of the action to be taken for the secured creditor to become the account holder depends on the banking law and practice of the enacting State. For example, the name of the secured creditor may replace the name of the grantor as an account holder or the account of the grantor may be debited and the account of the secured creditor may be credited.

Article 24. Negotiable documents and tangible assets covered

122. Article 24 is based on recommendations 51-53 of the Secured Transactions Guide (see chap. III, paras. 154-158). It is intended to deal with the effect of the third-party effectiveness of a security right in a negotiable document on the third-party effectiveness of a security right in the tangible assets covered by the document.

123. Under paragraph 1, if a security right in a negotiable document (which extends to the assets covered by the document under article 14) is effective against third parties, the security right in the assets covered by the document is also effective against third parties. Under paragraph 2, possession of the document is sufficient to make effective against third parties also the security right in the assets covered by the document. Under paragraph 3, the security right referred to in paragraph 2 remains effective against third parties even after the secured creditor gives up possession of the document for a short period of time.

124. Enacting States that are parties to the Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes (Geneva, 1930; the “Geneva Uniform Law”) may wish to consider including in the asset-specific section of the creation or

third-party effectiveness chapter a provision that a security right in a negotiable instrument may be created and made effective against third parties by delivery and endorsement containing the statement "value in security" ("valeur en garantie"), "value in pledge" ("valeur en gage"), or any other statement implying a security right (see art. 19 of the Geneva Uniform Law and art. 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes (the "Bills and Notes Convention"), which contains a similar rule). An enacting State that decides to do so will have to adjust article 27 of the Model Law to deal with the comparative priority of such a security right.

Article 25. Uncertificated non-intermediated securities

125. Article 25 is a new provision that does not correspond to any of the recommendations of the Secured Transactions Guide, which did not apply to any type of securities (see rec. 4, subpara. (c)). It adds a new asset-specific method of third-party effectiveness, that is, notation of the security right or entry of the name of the secured creditor as the holder of the securities in the books maintained for recording the name of the holder of the securities by or on behalf of the issuer. It also reiterates the conclusion of a control agreement as a method of third-party effectiveness with respect to a security right in non-intermediated securities (not just rights to payment of funds credited to bank accounts; see art. 2, subpara. (g)).

126. Enacting States parties to the Geneva Uniform Law may wish to include in the asset-specific section of the creation or third-party effectiveness chapter a provision that a security right in non-intermediated securities may be created and made effective against third parties by delivery and endorsement containing the statement "value in security" ("valeur en garantie"), "value in pledge" ("valeur en gage"), or any other statement implying a security right (see art. 19 of the Geneva Uniform Law and art. 22 of the Bills and Notes Convention, which contains a similar rule). An enacting State that decides to do so will have to adjust article 46 of the Model Law to deal with the comparative priority of such a security right.