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Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions

Note by the Secretariat

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V.18-06561 (E)

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1. A secured creditor will want to make sure that its security right is effective against third parties as the security right will otherwise not be of much benefit. The most usual way to make a security right effective against third parties under the Model Law is to register a "notice" in the Registry, where information on the possible existence of security rights are contained. The order of registration generally determines the order of priority of security rights in the same asset (see section G).

2. As the Model Law contemplates a "notice-based" registration system, the registrant needs to only submit a simple notice setting out the basic information needed to alert interested third parties to the potential existence of a security right. It is important for users of the Registry to understand that a registered notice merely indicates that a security right may exist in the assets.

1. Who should register?

3. Obviously, secured creditors would have an interest in registering a notice in the Registry. This would include sellers that retain ownership of the assets sold to the buyers to secure the purchase price (see example #5A) as well as lessors that provide credit to support the acquisition of assets. As the Model Law also applies to outright transfers of receivables, transferees of receivables would also have an interest in registering a notice in the Registry (see example #9).

4. Registration will usually be done by the secured creditor. A secured creditor may delegate the task to another person, such as, its lawyer or a firm that specializes in providing this service. However, the secured creditor is responsible for any errors or omissions made by its authorized registrant. Thus, the secured creditor should make sure that it will have recourse against the registrant in the event of error (for example, by ensuring that the registrant is insured against liability for its errors). Even then, the secured creditor should promptly verify that the registration has been made correctly.

2. When to register?

5. Registration need not follow the conclusion of a security agreement. A notice can be registered at any time, even before the security agreement is concluded or the security right is created ("advance registration"). Thus, to benefit from the general priority rule ranking competing security rights by the order of registration, a secured creditor should consider registering as soon as the general content of the financing arrangement has been agreed.

6. Secured creditors should take caution as advance registration does not necessarily provide protection against the consequences of the grantor losing the power to dispose of assets before the actual creation of the security right. If, before that point, the grantor transfers the assets described in the notice, or a judgment creditor obtains rights in those assets, the security right will not be effective against the buyer and will be subordinate to the rights of the judgment creditor. Similarly, if insolvency proceedings are commenced in respect of the grantor before the security agreement is concluded, the security right will likely not be effective. Thus, secured creditors should not rely on advance registration as a reason to delay conclusion of the security agreement.

3. How to register?

7. The registration process contemplated in the Model Law is straightforward and efficient. To register an initial notice, the registrant need only submit its completed notice to the Registry in the prescribed form, provide evidence of its identity in the prescribed manner and pay the prescribed fees, if any. The requirements for registering an amendment or cancellation notice are the same except that the registrant must also satisfy the secure access procedures specified by the Registry.

8. A registration is effective as soon as the information in the notice submitted to the Registry is publicly searchable (art. 13 of the Registry Provisions). In most States, the Registry would be electronic, meaning that access to registry services for both registration and searches could be done directly over the Internet or via network systems. As such, the prescribed form for registering a notice will also be electronic. This would enable registrants to enter the information directly into the records of the Registry ensuring that the information is publicly searchable almost immediately after it is entered.

9. For detailed guidance on the registration process, registrants should refer to the specific guidelines provided by the Registry. These guidelines explain matters such as the mode of electronic transmission of information, how to set up and operate user accounts as well as secure access requirements (for example, access codes or credentials) for registering an amendment or cancellation notice.

4. What to register — information to be included in an initial notice?

10. The following information should be included in an initial notice:

- The name and addresses of the grantor
- The name and addresses of the secured creditor or its representative and
- A description of the encumbered assets.

Name and address of the grantor

11. It is important that the initial notice sets forth information regarding the grantor in an accurate manner. Where the grantor is not the debtor of the secured obligation, the notice should include information about the grantor and not the debtor.

12. The correct name of the grantor for registration purposes would be specified by each State, usually with reference to the relevant official document. In addition to the name and address of the grantor, States may require additional information to assist in uniquely identifying the grantor. Thus, the secured creditor should be fully aware of these requirements and obtain the specified document from the grantor or conduct a search of the public record and enter the correct name of the grantor in the notice.

13. Setting out the correct name of the grantor is particularly important because this is the primary criterion for searching the Registry (see section C). If a search of the Registry using the correct name does not disclose the registered notice, that registration would not be effective (regardless of whether the Registry provides for a “exact match” or “close match” system). The security right would thus not be effective against third parties. Registrants should take due caution to avoid errors when entering the identifier of the grantor.

Name and address of the secured creditor or its representative

14. The initial notice should also set out the name and address of the secured creditor or its representative. The name of a representative would typically be used where the obligation is owed to a syndicate of lenders since only one name and address — that of the lead lender or other representative of the syndicate — needs to be entered.

15. The correct name of the secured creditor or its representative for registration purposes would also be specified by each State, along the same lines as the correct

name of the grantor. However, unlike the name of the grantor, the name of the secured creditor or its representative is not a search criterion in the Registry. Therefore, an error would not render the registration ineffective unless it would seriously mislead a reasonable searcher.

16. Nonetheless, care should be taken to enter the correct name as well as the accurate address of the secured creditor. This will ensure that the secured creditor or its representative receives any communications from third parties who relied on the information set out in the notice. This may include a subsequent secured creditor wishing to obtain a subordination, those wishing to obtain an acquisition security right in the asset, and competing secured creditors informing their intent to proceed with enforcement.

Description of the encumbered assets

17. The initial notice must also describe the encumbered assets to reasonably allow their identification. The inclusion of a description is necessary to enable searchers to determine which of the grantor's assets may be the subject of a security right.

18. As illustrated in sections A and B, a security right can be created in specific assets, assets within a generic category as well as all of the grantor's assets. Therefore, description of the encumbered assets in the notice need not necessarily be specific. Even when the encumbered asset is a specific item, it is sufficient if the description enables identification of the relevant asset. For example, "the grantor's car" would be sufficient if the grantor owns only one car. If the encumbered assets fall within a generic category, it is sufficient if the description refers to the generic category, for example, "all of the grantor's present and after acquired inventory." If the security right is intended to cover "all the grantor's present and future movable assets," a description using those words is likewise sufficient.

19. Generic descriptions may be combined with specific descriptions if the parties wish to exclude some assets from the category of assets intended to be the subject of the security right (for example, "all present and future receivables owing to the grantor except receivables owed by Company X" or "all of grantor's present and future assets except inventory manufactured by Company X").

20. In general, the secured creditor should avoid describing the assets in a way that might require it to register an amendment notice due to subsequent events. For example, describing assets by their location ("all equipment located at 123 Street, Capital City") should be avoided unless the secured creditor is confident that the assets will remain at that location for the duration of the financing relationship.

21. The parties may contemplate entering into a series of security agreements over time; for example, an initial agreement covering a specific item of equipment to secure a loan, and a subsequent agreement covering all the grantor's present and future movable assets to secure a line of credit. In such case, the registration of a single notice is sufficient to cover security rights created under multiple security agreements (art. 3 of the Model Registry Provisions). Therefore, if the secured creditor registered a notice describing the encumbered assets as "all present and future assets of the grantor" at the time of the initial security agreement, it would not need to register a separate notice with regard to the subsequent security agreement. It would also ensure that security rights over assets covered by all of the agreements generally have priority against competing secured creditors who subsequently registered their notices.

Period of effectiveness of the registration

22. A secured creditor may also need to indicate in the notice how long the registered notice would be effective. This would depend on which option the enacting State implements with regard to the period of effectiveness of a registration (art. 14 of the Model Registry Provisions). If the period of effectiveness is fixed (option A), a secured creditor would not need to indicate this information in the notice. However,

if the secured creditor is allowed to determine the period of effectiveness (options B and C), that period must be set out in the initial notice. Registrants are advised to select a period that corresponds to the contemplated life cycle of the financing to avoid the need to register an amendment notice extending the period of effectiveness.

Statement of the maximum amount for which the security right may be enforced

23. Some States may require that the security agreement indicate the maximum amount for which the security right may be enforced (art. 6(3)(d) of the Model Law, see section D). In those States, a secured creditor would also need to indicate that maximum amount when it registers a notice relating to that agreement. This allows a grantor to use the residual value of the encumbered asset to obtain financing from subsequent creditors.

> **Example #13:** Company X has a printing business and wants to take a loan of up to 10,000 USD from Bank Y. Bank Y makes the loan and takes security over Company X's printing press with an estimated value of 30,000 USD. State A requires that the security agreement and the notice in the Registry state the maximum amount for which Bank Y will enforce its security right. Accordingly, Bank Y registers a notice indicating the maximum amount as 10,000 USD as stated in the security agreement.

24. In example #13, Bank Y is secured with the printing press up to 10,000 USD and is unsecured for any credit that it extends to Company X beyond that amount. Thus, a subsequent creditor may be willing to extend credit against the residual value of the printing press (20,000 USD). This illustrates why a secured creditor should ensure that the maximum amount set out in the security agreement as well as in the registered notice is sufficient to cover all credit that it intends to be secured as well as any anticipated cost of enforcement.

Other information

25. Whereas the secured obligation needs to be described in a security agreement, it does not need to be included in the notice relating to the security right. A notice-based registration system ensures that any confidential or proprietary information contained in the security agreement remains private. Therefore, secured creditors should ensure that any information that should remain confidential, or beyond what is required in the notice, is not included when registering a notice in the Registry.

[*Note to the Working Group: The Working Group may wish to consider reproducing the sample initial notice form in Annex II of the Registry Guide (pp. 137-139) here or inserting a hyperlink.*]

5. When to register an amendment notice?

26. There may be instances where the information in a registered notice needs to be revised. Only the person identified as the secured creditor in the registered initial notice is authorized to register an amendment or cancellation notice. The only exception is when an amendment notice identifying a new secured creditor is registered, in which case only the new secured creditor is authorized to register an amendment or cancellation notice (see para. 33).

27. The following are some typical circumstances in which a secured creditor should consider registering an amendment notice. The information to be included in an amendment notice would differ depending on the circumstances.

Correction of errors or omissions in registered notices

28. After a notice is registered, the person identified as the secured creditor in the notice would receive a copy of the information in the registered notice, including the date and time of registration and the assigned registration number. The secured

creditor should immediately inspect the sufficiency and accuracy of the information and register an amendment notice if there are any errors or omissions. Like an initial notice, an amendment notice is effective only from the time the information is publicly searchable. Consequently, speed is of the essence in correcting errors or omissions in the public registry record.

Change in the name of the grantor

29. The name of the grantor may change after a notice is registered: for example, an individual may have changed its name legally or a company may have merged with another company and decided to use the name of the other company. To preserve its priority against subsequent competing secured creditors and buyers of the encumbered asset, the secured creditor should register an amendment notice adding the new name of the grantor before expiry of the prescribed grace period (art. 25 of the Model Registry Provisions). Otherwise, its security right may be subordinate to a subsequent secured creditor that registers a notice using the grantor's new name. Similarly, the security right may not be effective against a subsequent buyer who purchased the asset from the grantor after the grantor changed its name.

Example #14: Farmer X take a loan from Bank Y and grants a security over its crops. Bank Y registers a notice in the Registry indicating Farmer X as the grantor on 18 October 2018. Farmer X applies to have his name changed to Farmer W and the application is approved on 18 December 2018. On 1 January 2019, Bank Z extends credit to Farmer W and takes security over its crops. Bank Z registers a notice on the same day indicating Farmer W as the grantor. State A includes a grace period of 90 days for a secured creditor to address changes in the name of the grantor.

30. In example #14, Bank Y can preserve its priority by registering an amendment notice disclosing Farmer W as the grantor (by adding Farmer W in the notice) before the expiry of 90 days after the name change. In that case, Bank Y would retain priority as against Bank Z. Bank Y can still register an amendment notice after expiry of the 90-day period. However, the priority of its security right will not be preserved against secured creditors or buyers who acquired their rights after Farmer X changed its name to Farmer W and before the amendment notice was registered (for example, Bank Z or a buyer who purchased crops from Farmer W).

31. The prescribed grace period would usually be a reasonable period for the secured creditor to monitor and find out about the change in the name of the grantor. To protect itself against the priority risk posed by such change, the secured creditor should periodically monitor the status of the grantor.

Changes in secured creditor information

32. A secured creditor may change its name or address or both after the initial notice is registered. Such subsequent change does not prejudice the effectiveness of a registered notice in any way. However, a secured creditor will generally want to update the public registry record to disclose the change(s) to ensure that it receives any notices or other communications sent by third parties. Updating can be done either by registering a single amendment notice, or requesting the Registry to amend the information in multiple registered notices in which the person is identified as secured creditor (art. 18 of the Model Registry Provisions, options A and B).

33. A security right may be assigned to a new secured creditor. In such circumstances, while not required to preserve the effectiveness of the registration, the initial secured creditor may register an amendment notice indicating the new secured creditor. Once the amendment notice is registered, only the person identified in the amendment notice as the new secured creditor would be authorized to register an amendment or cancellation notice (art. 16(2) of the Model Registry Provisions). To avoid the risk that the initial secured creditor may inadvertently or without authority amend or cancel the registration, the new secured creditor should ensure that the

access credential provided by the Registry to the initial secured creditor is invalidated and a new credential is issued to the new secured creditor.

Addition of a description of new encumbered assets

34. A secured creditor may have registered an initial notice, in which the description of the encumbered assets is not sufficient to cover new assets that the grantor has agreed to provide as security. In such circumstances, the secured creditor should register an amendment notice describing the new assets. The secured creditor could instead register a new initial notice covering the new assets. However, registration of an amendment notice may be more efficient since it avoids the need to re-enter all the other information required in an initial notice.

35. The security right in the new assets will be effective against third parties only from the time the amendment notice or the new notice is registered. Therefore, its priority would be subordinate to any previously registered competing security right. This is why it may be useful for a secured creditor to register an initial notice to cover all possible assets that the grantor may provide as security (see para. 21 above).

Addition of a description of proceeds of encumbered assets

Example #15: Company X and Bank Y concluded a security agreement covering Company X's computer equipment. Bank Y registered a notice describing the computer equipment. Subsequently, Company X sells the computer equipment and is paid in cash, which Company X later deposits in its bank account.

36. A security right automatically extends to any proceeds that can be identified as derived from the encumbered asset. If the secured creditor registers a notice with respect to its security right and the proceeds of the encumbered asset take the form of money, receivables, negotiable instruments or funds credited to a bank account, the secured creditor does not need to take any additional steps to make its security right in the proceeds effective against third parties (see example #12). The security right in proceeds would also have the same priority as that in the original encumbered asset, based on the date of registration of the initial notice (art. 32).

37. In example #15, Bank Y's security right in the money received by Company X (proceeds), and in the right to the funds credited to Company X's bank account (proceeds of proceeds), is effective against third parties without the need for Bank Y to register an amendment notice or otherwise make its security right effective against third parties (art.19(1)). However, Bank Y's security right in the funds credited to Company X's bank account is fragile, as the deposited amount would be commingled with existing funds in the bank account. In that case, the Bank Y's security right is limited to the deposited amount and terminates if the balance of the bank account later falls below the value of the balance immediately before the funds were deposited (art. 10(2)). Moreover, even if Bank Y retains its security right in the funds credited to the bank account, its priority is subject to the special priority rules governing security rights in bank accounts under which subsequent secured creditors, including particularly the depository bank, will often have priority (art. 47).

38. If Company X, instead of depositing the cash in its bank account, used the cash to purchase a new van, Bank Y's security right will extend to the new van (proceeds of proceeds). However, unlike funds credited to a bank account, Bank Y will need to take additional steps to make its security right in the van effective against third parties and retain its priority (art. 19(2)). Suppose that Company X, upon purchase of the van, immediately granted a security right in the van to Bank Z and Bank Z promptly registered a notice of its security right. Bank Y would need to register an amendment notice adding the description of the van before the expiry of the prescribed grace period to preserve its priority over the van. If Bank Y registers an amendment notice after the grace period, priority between the security rights of Bank Y and Bank Z would be determined by the general first-to-register rule. One way for Bank Y to avoid

this situation would have been to include potential proceeds within the description of the encumbered asset in the security agreement and in the registered notice (for example, “all present and future tangible assets” instead of “computer equipment”).

39. The examples above illustrate that a secured creditor should not passively rely on its security right in any proceeds of the encumbered asset. It should continuously monitor the encumbered assets to ensure that it is in a position to take the necessary steps to preserve the third-party effectiveness and priority of its security right in the proceeds, including, if necessary, the registration of an amendment notice adding a description of the proceeds.

Addition of a buyer of an encumbered asset from the grantor as a new grantor

40. Registration of a notice generally protects the secured creditor against an unauthorized sale of the encumbered asset by the grantor. Unless the asset is sold in the ordinary course of the grantor’s business, the security right continues in the asset in the hands of the buyer. The buyer is automatically considered to be an additional grantor. However, once the asset is in the hands of the buyer, a searcher will typically conduct a search in the Registry using the name of the buyer. This would not reveal the security right in the encumbered asset as the notice would have been registered against the name of the seller (the grantor).

41. A secured creditor is generally not required to register an amendment notice following an unauthorized sale of the encumbered asset by the grantor. However, to preserve the third-party effectiveness and priority of its security right against a subsequent buyer or subsequent secured creditor who acquire their rights from the original buyer, the secured creditor may need to register an amendment notice. This would depend on which of the three options the enacting State implements with regard to post-registration transfer of encumbered assets (art. 26 of the Model Registry Provisions).

Example #16: Company V and Bank Y concludes a security agreement covering Company V’s computer equipment. Bank Y registers a notice indicating Company V as the grantor. Subsequently, Company V sells the computer equipment to Company W. Company W then sells half of the computer equipment to Company X. It also obtains a loan from Bank Z using the remaining computer equipment as security.

42. In States that implement option A, Bank Y needs to register an amendment notice adding Company W as a new grantor. If the registration is made before expiry of the prescribed grace period, the third-party effectiveness and priority of Bank Y’s security right is preserved against Company X (a subsequent buyer) and Bank Z (a secured creditor that acquire its rights from Company W). The result is the same in States that implement option B except that the prescribed grace period for Bank Y to register an amendment notice is not triggered until Bank Y knows that Company V sold the computer equipment to Company W.

43. Under both options, Bank Y can still register an amendment notice even after expiry of the prescribed grace period. However, the effectiveness and priority of Bank Y’s security right will not be preserved, if, prior to the amendment notice registration, Company X acquired the computer equipment and Bank Z registered its initial notice with regard to the computer equipment.

44. In States that implement option C, Bank Y does not need to register an amendment notice. The third-party effectiveness and priority of its security right is preserved against all third parties including Company W, X and Bank Z. Nonetheless, Bank Y may still want to register an amendment notice to avoid any priority disputes. In States that implement option C, the burden would be on the prospective secured creditor or buyer to investigate whether the current owner acquired the assets subject to a security right granted by a previous owner. In other words, Company X and Bank

Z would need to conduct due diligence to find out if Company W had acquired the computer equipment subject to the security right granted by Company V to Bank Y.

Extension of period of effectiveness of a registration

45. If it appears that the financing relationship between the parties may extend beyond the period of effectiveness of the initial notice, the secured creditor should register an amendment notice to extend the period of effectiveness. The secured creditor should establish a monitoring system to ensure that it is alerted to the upcoming expiry of its registrations in the Registry giving it sufficient time to register an amendment notice before the period lapses.

[*Note to the Working Group: The Working Group may wish to consider reproducing the sample amendment notice form in Annex II of the Registry Guide (pp. 140-144) here or inserting a hyperlink.*]

6. What are the obligations of the secured creditor?

Obtaining authorization from the grantor

46. A secured creditor should be aware that registration of an initial notice requires authorization in writing by the grantor. The same applies to registration of certain amendment notices, in particular, those that add a grantor or encumbered assets. If not authorized by the grantor, the registration would be ineffective and the security right would not be effective against third parties.

47. It is left to the secured creditor to obtain the authorization from the grantor and the Model Law provides flexibility in this regard. For example, a secured creditor need not obtain the authorization before registration and the grantor's subsequent authorization operates retroactively to make the registration effective. A written security agreement is automatically deemed to constitute authorization, regardless of whether the agreement was concluded before or after registration. In practice, a secured creditor would usually obtain authorization from the grantor in a separate document. Annex V provides one such example of a grantor's authorization in email format.

Annex V: Sample Authorization

Thu 18/10/2018 20:00

John Smith <cfo@moderntechnologies.com>

Subject: Notice Registration Authorization

To: *financial_advisor@bankofwealth.com*

MODERN TECHNOLOGIES INC. hereby authorizes BANK OF WEALTH and any of its representative to register a notice in the [*name of the security right registry to be specified*] with respect to a security right, which MODERN TECHNOLOGIES INC. intends to grant to BANK OF WEALTH in [all its present and future movable assets] or [in the following category of assets]:

(a) Inventory;
(b) Receivables;
(c) Equipment;

This authorization will be subject to and valid until the conclusion of a security agreement between MODERN TECHNOLOGIES INC. and BANK OF WEALTH with respect to the assets listed above.

John Smith
CFO, MODERN TECHNOLOGIES INC.
[*Signature block*]

48. Obtaining authorization is, however, not part of the registration process and the Registry is prohibited from requiring the registrant to provide evidence of the grantor's authorization (art. 2(6) of the Model Registry Provisions). This generally contributes to the efficiency of the registration process.

49. However, the person identified in the notice as the grantor may face difficulties in obtaining credit using assets described in the notice, particularly if no security agreement is concluded between the parties or the concluded agreement covers a narrower range of assets than those described in the notice.

Obligation to send a copy of a registered notice

50. To ensure that the grantor is aware of notices registered under its name, the secured creditor is required to send the grantor a copy of the information in the registered notice. This should be done within a specified period after the secured creditor receives the information from the Registry. While failure of the secured creditor to comply with this obligation would not affect the registration, the secured creditor may be liable to the grantor for a nominal amount and any actual loss or damage suffered by the grantor.

Compulsory registration of an amendment or cancellation notice

51. The secured creditor may be required to register an amendment or cancellation notice to protect the grantor against notices that do not reflect an existing or contemplated security agreement. The following table provide a summary of such circumstances.

• There is no authorization by the grantor in relation to those assets and the grantor has informed the secured creditor that it will not authorize such registration. • Initial authorization by the grantor is withdrawn and no security agreement covering those assets is concluded. ⇨ An amendment notice deleting assets from the description in a notice must be registered.
• There is no authorization by the grantor of the initial notice and the grantor has informed the secured creditor that it will not authorize the initial notice. • Authorization by the grantor of the initial notice is withdrawn and no security agreement is concluded. ⇨ A cancellation registration must be registered.
* In the circumstances above, the secured creditor may not charge or accept a fee or expenses for registering the notices.

52. There may be instances where the secured creditor is required to register an amendment or cancellation notice even though a security agreement has been concluded covering the assets described in the notice. For example, if the security agreement has been revised to release certain assets and the grantor has not otherwise authorized the registration of a notice covering those assets, the secured creditor must register an amendment notice deleting those assets. If all secured obligations have been discharged and the secured creditor is not committed to extend any further secured credit, the secured creditor must register a cancellation notice. In these circumstances, the secured creditor may charge a fee for complying with its obligation.

[*Note to the Working Group: The Working Group may wish to consider reproducing the sample cancellation notice form in Annex II of the Registry Guide (p. 144) here or inserting a hyperlink.*]

53. Secured creditors should exercise great caution when registering an amendment or cancellation notice, particularly when the registered notice relates to multiple security rights created under different security agreements. A secured creditor should not register a cancellation notice simply because the obligations secured under one security agreement were satisfied. Similarly, a cancellation notice should not be registered because one of the grantors was released. Instead, an amendment notice removing the released grantor should be registered.

54. In most cases, the secured creditor will voluntarily comply with the obligations mentioned above. If it fails to do so, the grantor can send a written request. Annex VI provides an example of a grantor's request in email format. If the secured creditor does not comply within the prescribed period after receiving the request, the grantor may seek an order for registration of an amendment or cancellation notice. Upon issuance of the order, the Registry would be obliged to register the notice without delay.

[*Note to the Working Group: The Working Group may wish to consider reproducing the sample amendment/cancellation notice form pursuant to a judicial or administrative order in Annex II of the Registry Guide (pp. 146-149) here or inserting a hyperlink.*]

Annex VI: Sample Request for an Amendment or Cancellation Notice

Thu 18/2/2019 20:00

John Smith <cfo@moderntechnologies.com>

Subject: Request for an amendment/cancellation notice

To: financial_advisor@bankofwealth.com

MODERN TECHNOLOGIES INC. (the Company), hereby requests BANK OF WEALTH (the Bank) to register an amendment notice with regard to Notice No. 12341234, which the Bank registered in the [*name of the security right registry to be specified*] on 18 October 2018 based on the authorization given to it by the Company with respect to security rights in all its present and future movable assets. As the subsequent security agreement concluded between the Company and the Bank on 18 November 2018 excluded receivables owed to the Company and funds credited to the Company's bank accounts, the Company hereby withdraws its authorization with respect to those assets and requests the Bank to register an amendment notice deleting those assets from the description of encumbered assets in Notice No. 12341234.

or

MODERN TECHNOLOGIES INC. (the Company), hereby requests BANK OF WEALTH (the Bank) to register a cancellation notice with regard to Notice No. 12341234, which the Bank registered in the [*name of the security right registry to be specified*] on 18 October 2018 based on the security agreement concluded between the Company and the Bank on 18 November 2018. As all obligations under the credit agreement and the security agreement have been performed and as the Company will no longer seek credit from the Bank, the Company hereby requests the Bank to register a cancellation notice with regard to Notice No. 12341234.

If the Bank does not comply with the above request within [ ] days after receipt of this letter, the Company will seek an order of registration of an amendment/cancellation notice by application to [.....].

John Smith
CFO, MODERN TECHNOLOGIES INC.
[*Signature block*]

7. Unauthorized registration of amendment or cancellation notices

55. Only the person identified as the secured creditor in a registered notice is authorized to register an amendment or cancellation notice. The registration of an amendment or cancellation notice requires the registrant to satisfy the secure access requirements set by the Registry. To guard against the risk of an unauthorised amendment or cancellation, secured creditors should institute procedures to preserve the confidentiality of their access credentials.

56. If a secured creditor registers an amendment or cancellation notice inadvertently or in error, the registration is nonetheless effective. The same is true if the error is made by a person who the secured creditor authorized to make registrations on its behalf.

57. There may, however, be instances where despite all precautions, an unauthorized person gains access to the secured creditor's access credentials and registers an amendment or cancellation notice. The effectiveness of such unauthorized registration depends on which option is implemented by the enacting State (art. 21 of the Model Registry Provisions).

	Unauthorized registration of an amendment or cancellation notice
Option A	Effective (the third-party effectiveness and priority is lost)
Option B	The same as option A except that the priority of the security right is preserved as against a competing right that arose before the registration and over which the security right had priority before the registration
Option C	Ineffective (the third-party effectiveness and priority is preserved)
Option D	The same as option C except as against a competing right acquired in reliance on a search of the registry record made after the registration and provided that the competing claimant did not know that the registration was unauthorized when it acquired its right

58. In States implementing options A or B, the registration of a cancellation notice would result in the initial notice being removed from the publicly searchable record and a search of the Registry would not disclose the cancelled registration (art. 30 of the Model Registry Provisions, option A). A secured creditor may wish to register a new initial notice to re-establish third-party effectiveness as soon as possible, though the security right would be effective against third parties only as of that time. A secured creditor should be mindful that a security right registered after the cancellation notice and before the new initial notice would have priority regardless of whether option A or B is implemented.

59. In States implementing options C or D, the initial notice would remain publicly searchable notwithstanding registration of the cancellation notice (art. 30 of the Model Registry Provisions, option B). A searcher of the Registry may need to contact the secured creditor to verify whether it had authorized registration of the cancellation notice. A secured creditor may wish to inform the Registry that the cancellation registration was unauthorized and take measures to reinstate the initial notice.

8. Registration in other registries

60. Security rights in certain categories of assets may need to be registered (or also registered) in other registries, which are typically asset-based. Some examples of assets subject to specialized registration are:

- Intellectual property within the scope of an intellectual property registry (for example, a trademark, patent, or copyright registry)

- Aircraft frames and aircraft engines within the scope of the international registry established by the Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Protocol
- Aircrafts
- Ships
- Assets associated with immovable property registered in the land registry (for example, timber, growing crops, accessions to immovables, rents or other revenue streams derived from immovables)
- Rolling stock
- Motor vehicles and
- Manufactured homes.

[*Note to the Working Group: References are made to specialized registries in different parts of the Practice Guide. Considering that sections C and E deal more specifically with searching and registering in the "Registry", the Working Group may wish to consider placing the paragraph above in section B (see para. 22 of A/CN.9/WG.VI/WP.79/Add.1)*]

F. The need for continued monitoring

61. Diligence is not merely something to be done at the outset of a secured transaction. Rather, it is a continuous process that must be conducted, at least to a certain extent, during the entire life of the financing arrangement. This section discusses basic tools that secured creditors could use to monitor secured lending. Some of these tools relate to the monitoring of the collateral, while others relate to the monitoring of the borrower or the grantor. Monitoring tools for a secured lending are typically used in addition to, and not in lieu of, monitoring tools used in unsecured lending. For example, the borrower may agree to deliver to the lender periodic financial statements and to comply with various financial and other covenants. These requirements would usually be set out in the loan agreement.

1. Continued monitoring of the grantor

62. A prudent lender will conduct periodic monitoring of the grantor to detect changes that may require additional action to preserve the third-party effectiveness and priority of its security right. The secured creditor will want to monitor any changes in the grantor's name, mergers or any other changes affecting the grantor's legal status. Such changes may require the registration of an amendment notice (see section E.5).

63. A secured creditor must also be alert to the existence of third-party claims against the grantor, particularly preferential claims, which may be accorded priority over the security right by the State's laws. A secured creditor would need to conduct periodic inquiries or searches of the relevant registries to ascertain the existence of any such claims, and make certain that they are addressed by payment or subordination, or by withholding future loans. For example, the applicable law may give priority to tax lien claims over a security right created to secure a revolving loan, if a loan is made more than 45 days after a notice of the tax lien is filed in the appropriate registry. In that case, the secure creditor should conduct a search of that registry every 45 days to make sure that it is alerted to the existence of tax lien claims, so that it can then decide whether to make further revolving loans to the grantor.

2. Continued monitoring of the encumbered asset

Example #17: Company X sells kitchen appliances to restaurant owners. Many of its sales are on credit, with the customers paying for the appliance over a certain period. Company X needs operating funds from time to time to pay its ordinary expenses. Bank Y is prepared to advance funds by setting up a line of credit that Company X can draw on when it needs funds, as long as Bank Y is given security over all of Company X's existing and future inventory and receivables, and collections on the receivables are used to pay down the line of credit.

64. Where the financing transaction consists of a revolving credit facility secured by a borrowing base comprised of receivables and inventory, the borrowing base itself serves as a key tool for monitoring the encumbered asset. As agreed with the secured creditor, the grantor will periodically (e.g. once per week or once per month) submit a "borrowing base certificate" that describes in detail the nature of the receivables and inventory. Annex VII provides an example of a typical borrowing base certificate.

Annex VII: Sample Borrowing Base Certificate

BORROWING BASE CERTIFICATE				
			No.	
Name of Borrower: MODERN TECHNOLOGIES INC.			Date:	
Loan Number:			Period Covered: to	
CATEGORY OF ASSETS	**Receivables**	**Inventory**	**Total Eligible Collateral**	
Description				
1 Beginning Balance (Previous certificate, line 8)				
2 Additions to Collateral (Gross Sales or Purchases)				
3 Other Additions				
4 Deductions to Collateral (Cash Received)				
5 Deductions to Collateral (Discounts, other)				
6 Deductions to Collateral (Credit Memos, all)				
7 Other non-cash credits to Receivables				
8 **Total Ending Collateral Balance**				
9 Less Ineligible - Past Due				
10 Less Ineligible - Cross-age (___%)				
11 Less Ineligible – Foreign				
12 Less Ineligible – Set-off				
13 Less Ineligible - Other (attached schedule)				
14 **Total Ineligibles – Receivables**				
15 Less Ineligible -- Inventory Slow-moving				
16 Less Ineligible -- Inventory Offsite or In-transit				
17 Less Ineligible -- Inventory Work in process(WIP)				
18 Less Ineligible – Consigned				
19 Less Ineligible -- Other (attached schedule)				
20 **Total Ineligible - Inventory**				
21 **Total Eligible Collateral**				
22 Advance Rate Percentage	%	%		
23 **Net Available - Borrowing Base Value**				
24 Reserves (other)				
25 **Total Borrowing Base Value**				
25A **Total Availability/CAPS**				
26 **Revolver Line**			**Total Revolver Line**	
27 **Maximum Borrowing Limit (Lesser of 25 or 26)***			**Total Available**	
27A **Suppressed Availability**				
LOAN STATUS				
28 Previous Loan Balance (Previous certificate, line 31)				
29 Less: A. Net Collections (Same as line 4) B. Adjustments/Other _____				
30 Add: A. Request for Funds B. Adjustments/Other _____				
31 New Loan Balance				
32 Letter of Credit/BA's outstanding				
33 **Availability Not Borrowed (Line 27 less lines 31 & 32)**				
34 **Term Loan**			**Total New Loan Balance:**	
35 **OVERALL EXPOSURE (Lines 31 & 34)**				

Pursuant to, and in accordance with, the terms and provisions of the Credit Agreement dated as of _____, ____ (as it may be amended or modified from time to time, the "Loan Agreement") among MODERN TECHNOLOGIES INC. (the "Borrower") and BANK OF WEALTH (the "Lender") the Borrower is executing and delivering to the Lender this Borrowing Base Certificate accompanied by supporting data (collectively referred to as the "Certificate"). The Borrower represents and warrants to the Lender that this Certificate is true and correct, and is based on information contained in the Borrower's own financial accounting records. The Borrower, by the execution of this Certificate, hereby ratifies, confirms and affirms all of the terms, conditions and provisions of the Agreement, and certifies that, as of this date, the Borrower is in compliance with the Agreement. Unless otherwise defined herein, capitalized terms used herein have the meanings ascribed thereto in the Agreement.

BORROWER NAME: MODERN TECHNOLOGIES INC.	AUTHORIZED SIGNATURE:

65. A borrowing base certificate enables the secured creditor to confirm that the outstanding principal amount of its loans to the borrower never exceeds the actual value of the underlying encumbered assets. A borrowing base certificate disregards receivables and inventory that are deemed to be "ineligible" for borrowing purposes. Ineligible receivables include, for example, (i) receivables that are past due beyond a specified number of days, (ii) receivables that are "deemed" to be past due because a sufficiently high percentage of the receivables owed by the same customer are past due, (iii) receivables owed by foreign customers, and (iv) receivables subject to set-off by the customer. Ineligible inventory includes, for example, (i) inventory that is obsolete or slow-moving, (ii) inventory that is not physically located on the premises of the grantor either because it is held by a third-party (such as a processor or a storage warehouse) or is in-transit to the grantor's place of business, and that is not covered by an acceptable agreement with the third party or carrier giving the lender access to, and control of, the inventory, (iii) inventory that consists of work-in-process which is not readily saleable, and (iv) inventory that is not owned by the grantor but rather has been delivered to the borrower on consignment.

66. If the outstanding loan balance exceeds the borrowing base (a condition known as being "out of formula"), the loan agreement typically will require the borrower to prepay the loan in the amount of such excess, so that the loan will be "in formula". The failure of the borrower to make such prepayment will constitute an event of default entitling the lender to exercise its rights under the loan agreement and applicable law. In this way, the secured creditor is assured that its loan will always be fully supported by the encumbered asset.

67. Although the borrowing base certificate is signed by the grantor, the secured creditor typically will not rely on the certificate alone. Rather, the secured creditor will take additional steps to verify the value of the encumbered asset. Thus, in the case of receivables, the secured creditor will periodically verify the existence and amount of receivables by contacting the debtors on the receivables. In the case of inventory, the secured creditor will periodically arrange for an appraisal, or physical count, or have the inventory appraised by a third-party appraiser who specializes in the type of inventory owned by the grantor. The secured creditor may also conduct periodic "field examinations" in which its representative visits the grantor's premises, reviews the grantor's books and records and inspects any tangible encumbered asset.

68. One benefit of a field examination is that it may uncover inadvertent or intentional actions by the grantor that can adversely affect the security right. For example, a grantor may have moved encumbered inventory from one third-party warehouse (where the warehouse operator had executed an access agreement with the secured creditor) to another third-party warehouse (where the operator had not executed an access agreement). Such change in location may be revealed by field examination, and the secured creditor could address the issue by obtaining a collateral access agreement from the new warehouse.

69. The monitoring of collateral should not unduly interfere with the grantor's ability to conduct its business. The loan agreement often will contain provisions specifying the number and frequency of appraisals and field examinations that the lender may conduct prior to the occurrence of an event of default at the grantor's expense, but may also provide that, in the absence of an event of default, the secured creditor may only conduct inspections or field examinations after it gives the grantor

reasonable notice of the proposed inspection or examination and only during normal business hours.

70. While an event of default is continuing, the secured creditor is justified in conducting such activities with less deference to its effect on the operation of the grantor's business, and may wish to reserve the right to conduct an unlimited number of inspections and field examinations while the grantor is in default under the loan or security agreement.

71. Continued monitoring of encumbered assets is not confined to revolving receivables and inventory financing. It is equally important in the case of loans secured by equipment and a secured creditor should make certain that the equipment is being properly maintained and is in a good state of repair. The same applies to other forms of encumbered assets such as commodities or art collections.

3. Continued monitoring of micro-enterprises

72. Ongoing monitoring of micro-enterprises and of the assets they provide as collateral are as important. The need for continued monitoring may even be more compelling in the case of micro-enterprises, because public information concerning such enterprises is not as readily available as it may be for larger enterprises, and because of the increased likelihood that micro-enterprises might change their name. Consequently, secured creditors of micro-enterprises may be less able to rely on the encumbered assets as an exit strategy in comparison to larger enterprises. Therefore, special consideration should be given when monitoring micro-enterprises, as the cost of appraisals, field examinations and verifications may be costlier than the amount secured.

G. Priority competitions

73. There may be multiple competing claimants with rights in the grantor's assets. For example, there may be more than one security creditor over the same asset. A person that purchased the asset from the grantor as well as persons with preferential claims recognized by the law of a State may also be competing claimants. The notion of priority is a means to resolve competition among such competing claimants and their rights. While issues of priority would usually arise at the time of enforcement of a security right, they may need to be resolved as relevant transactions take place. As the Model Law contains a comprehensive set of rules to address such situations, it is advisable that parties involved including secured creditors and grantors are fully aware of these rules and their consequences.

74. Considering the wide range of priority competitions that could arise, this section provides some examples of how typical competitions are resolved under the Model Law.

1. First-to-register rule

Example #18: Company X has a printing business and takes a loan from Bank Y for 10,000€. Bank Y takes a security right over the printing press valued at 20,000€ and registers a notice in the Registry on 18 October 2018. Company X requires additional operating expenses and takes a loan from Bank Z for another 8,000€. Bank Z makes the loan and takes a security right over the printing press. Bank Z registers a notice on 1 December 2018.

75. As illustrated in example #18, a grantor may create more than one security right over the same asset to utilize the full value of the asset. The general rule is that priority between competing security rights is determined by the order in which a notice relating to the security right is registered in the Registry. In the example, Bank Y has priority over Bank Z as it registered a notice prior to Bank Z. Even if Bank Z took possession of the printing press on 1 December 2018, this would not have an impact

on the priority of Bank Y as priority is determined by the order of third-party effectiveness.

2. Buyers, lessees and licensees of the encumbered asset

Example #19: Company X has a printing business and takes a loan from Bank Y. Bank Y provides the loan and takes a security right over the printing press of Company X and registers a notice in the Registry on 18 October 2018. Company X requires additional operating expenses and sells the printing press to Company Z.

76. It is possible that the encumbered asset is sold, leased or licensed to a third party. As a general rule, a security right made effective against third parties prior to the sale, lease or license of the encumbered asset would not be affected. The buyer, the lessee or the licenses would acquire the encumbered asset subject to the security right. In example #19, Company Z's right would be bound by the security right of Bank Y. Therefore, a prudent buyer would conduct a search of the Registry to see if there are any existing security rights over the asset it is acquiring.

77. There are, however, a few exceptions. The first exception is when the secured creditor authorized the sale or other transfer of the assets free of the security right. If Bank Y had authorized the sale to Company Z free of the security right, Company Z would not be bound by the security right of Bank Y. Bank Y's security right would, however, extend to its identifiable proceeds or the money received from Company X for the sale.

78. The second exception is when the sale was conducted in the ordinary course of the seller's business. If a person purchases a tangible asset from a grantor in the ordinary course of the grantor's business, the buyer will normally be able to take the asset free of any security right. For example, if Company X was in the business of manufacturing and selling printing presses, Company Z would acquire the printing presses free of Bank Y's security right as long as Company Z did not have knowledge that the sale violated the rights of Bank Y under the security agreement with Company X. In more general terms, under the Model Law, a customer who purchases merchandise from a retailer would acquire the goods free of any security right that the retailer might have granted over them. This reflects the expectation of the market participants.

3. Super-priority of an acquisition security right

Example #20: Company X has a printing business and takes a loan from Bank Y. Bank Y provides the loan and takes a security right over the printing press of Company X, including any other equipment or inventory that Company X will purchase in the future. Bank Y registers a notice in the Registry on 18 October 2018. In January 2019, Company X purchases computers from Vendor Z to use in its operation. Vendor Z's terms of sale state that it retains title to the computer equipment until Company X has paid the purchase price in full.

79. Another exception to the first-to-register rule relates to an acquisition security right, i.e. a security right granted to a financier that provided credit for the acquisition of an asset. If certain conditions are met, an acquisition security right has priority over a competing non-acquisition security right in the same asset, including a security right previously registered which would otherwise have priority under the first-to-register rule. In other words, acquisition financiers are given advantageous treatment under the Model Law.

80. In example #20, Bank Y would ordinarily have priority over the computers because it had registered a notice describing future assets that Company X would acquire and as the registration took place prior to the purchase of the computers. However, under the Model Law, Vendor Z, as an acquisition financier, would have

priority over Bank Y as long as Vendor Z registers a notice in the Registry within a specified period after Company X obtained the computers or the sales agreement was concluded.

81. Depending on the option implemented by the enacting State, the priority rules with regard to acquisition security rights in inventory may be slightly different from those in equipment (art. 38, option A). For example, suppose Vendor Z had supplied inventory (paper and ink) to Company X to be used in its operation. In such circumstance, Vendor Z could have priority over Bank Y provided that before Company X obtained possession of the paper and ink or before the conclusion of the sales agreement, Vendor Z registered a notice in the Registry and notified Bank Y that it has or intends to obtain a security right in the paper and ink.

82. If option B were to be implemented, the same rule would apply to acquisition security rights in equipment and in inventory. Regardless of whether the enacting State has implemented options A or B, an acquisition security right in consumer goods would always have priority over a competing non-acquisition security right created by the grantor.

4. Insolvency of the grantor

Example #21: Company X has a printing business and takes a loan from Bank Y. Bank Y provides the loan and takes a security right over the printing press of Company X and registers a notice in the Registry on 18 October 2018. Due to financial difficulties, Company X files for insolvency in December 2019.

83. Under the Model Law, the commencement of insolvency proceedings does not affect the priority of a security right as against competing claimants. In example #21, the security right of Bank Y would be recognized in the insolvency proceedings and its priority retained. However, this is subject to the insolvency law of the State which may give priority to rights of other claimants, for example, to the insolvency representative for the costs of the insolvency proceedings. Therefore, secured creditors should be aware of relevant provisions in the insolvency law to better understand their priority status once insolvency proceedings commence.

5. Preferential claims

Example #22: Company X has a printing business and takes a loan from Bank Y. Bank Y provides the loan and takes a security right over the printing press of Company X and registers a notice in the Registry on 18 October 2018. Company X has been late in paying taxes and salaries to its employees.

84. Secured creditors should also be aware of preferential claims that may be recognized in the enacting State. The Model Law provides a framework for the enacting State to implement other policy considerations by recognizing certain claims that would have priority over a registered security right (usually up to a certain maximum amount). For example, the enacting State may give priority to outstanding tax payments and claims of the grantor's employees for employment benefits. Accordingly, secured creditors may wish to deduct the potential amount of the preferential claims from the amount that they are prepared to extend credit (see sections 8 and 9 of the Sample Diligence Certificate).

85. While it is recommended that States clearly list claims that will have priority over security rights and to specify a cap on the amount given priority in their secured transactions law, a prudent secured creditor should also assess whether other laws recognize preferential claims which may have priority over its security right.

6. Judgment creditors

Example #23: Company X has a printing business and takes an unsecured loan from Bank Y. Company X was late in repaying the loan and Bank Y seeks a judgment from the local court. As Company X requires funds to continue its business, it takes a loan from Bank Z and Bank Z takes a security right over the printing press of Company X.

86. A creditor that has obtained a judgment or provisions order ("judgment creditor") may also have priority over a security right. The steps necessary for a judgment creditor to acquire rights in an asset differs depending on the law of each State. Under the Model Law, priority is given to the right of a judgment creditor if the required steps were taken before the security right became effective against third parties. For example, if Bank Y had registered a notice in the Registry or took possession of the printing press before Bank Z had registered its notice, Bank Y would have priority as a judgment creditor.

87. If the security right was made effective against third parties before or at the same time the judgment creditor acquired its rights, the secured creditor may have limited priority. For example, if Bank Z had registered its notice prior to Bank Y seeking a judgment from a local court, it would be protected from being subordinate to right of Bank Y as a judgment creditor, which did not exist at the time Bank Z made its security right effective against third parties. Bank Z's priority is limited to prevent Bank Z from using its priority status to increase the obligation owed to it even after Bank Z found out that Bank Y had taken steps to acquire rights. The limited priority also provides Bank Z a short period to adjust to the potential existence of Bank Y's rights.

H. How to enforce a security right

88. Under the Model Law, parties are given maximum flexibility in structuring how a security right could be enforced, provided that their agreement does not prejudice the rights of third parties or the mandatory rights and obligations of the parties under the enforcement provisions of the Model Law. The general standards of conduct in article 4 also apply to enforcement of a security right and secured creditors are thus expected to exercise their rights in good faith and in a commercially reasonable manner.

89. In enforcing its security right, a secured creditor need not necessarily apply to a court or other authority, which may be a significant change in many jurisdictions. The Model Law provides for extrajudicial enforcement, which makes it quicker and more efficient for a secured creditor to recover what it is owed. To minimise the risks that could be posed by misuse of such extrajudicial enforcement, the Model Law imposes a number of conditions on how a secured creditor could go about exercising its right.

1. Default and options for secured creditors

90. Default is a defining moment in secured transactions. It is when the secured creditor will assess the usefulness and effectiveness of its security right. While non-performance of the secured obligation by the debtor would be a typical event of default, insolvency of the debtor/grantor or commencement of enforcement by another secured creditor may also constitute events of default. Parties are free to determine in their security agreement events that would constitute or trigger default (see section D).

91. There are a number of options for secured creditors in the event of default. A secured creditor may choose to address the situation by means other than enforcing its security right. This is because enforcement is ordinarily detrimental for both the grantor, who will likely lose ownership of its assets, and for the secured creditor, who may not obtain the full amount that it is owed, as the proceeds of the disposition could

be less than the secured obligation. Therefore, a secured creditor may instead choose to restructure the loan repayment schedule with the debtor, obtain a security right in additional assets, or assign its security right to a third party.

92. However, a typical action to be taken by the secured creditor would be to enforce its security right in accordance with the security agreement and the provisions of the Model Law. The enforcement phase is critical because it is the point at which priority competitions will need to be resolved, particularly when distributing the proceeds of the disposition of the encumbered asset.

93. The Model Law provides different avenues for the secured creditor to pursue enforcement and obtain repayment of the amount due. A secured creditor may sell the encumbered asset and distribute the proceeds. A secured creditor can also lease or license the encumbered asset. A secured creditor may also seek to exercise its security right on the proceeds of the encumbered asset. It can also acquire the encumbered asset in total or partial satisfaction of the amount due. These choices would largely depend on the type of encumbered asset. For example, if the encumbered assets were receivables or funds credited to a bank account, a secured creditor may wish to collect payment rather than dispose of the encumbered asset.

2. Obtaining possession of the encumbered asset

Example #24: Company X has a printing business and takes a loan from Bank Y. Bank Y takes a security right over the vans of Company X.

94. Upon default, Bank Y wishes to enforce its security right in the vans, which is still located in the premises of Company X. Unless Bank Y had chosen to make its security right effective against third parties by taking possession of the vans, Bank Y will usually need to take possession of the vans for enforcement purposes.

95. Bank Y is entitled to obtain possession of the vans for enforcement purposes unless the vans are in the hands of a person with a superior right to possession.

96. One way to obtain possession is through court proceedings, which would provide a binding order so that the seizure can take place despite any unjustified objection from Company X in possession of the vans. Court proceedings are effective if the grantor is not cooperative in surrendering the assets. However, it may also lead to delays and pose problems if the encumbered assets were perishable or declining in value rapidly.

97. For this reason, Bank Y may have an interest in obtaining possession of the vans without applying to a court or other authority. This is only allowed when certain conditions are satisfied (art. 77(2)). Such limitations exist to balance the rights of the grantor and the creditor and to protect the public interest through a peaceful enforcement process.

98. In example #24, Bank Y must first obtain the written consent of Company X with regard to its extrajudicial possession, which is typically included in the security agreement, or subsequently provided through a separate document. Bank Y would also need to notify Company X (or any other person in possession of the vans) in advance that Company X was in default and that Bank Y intends to take possession of the vans. However, in cases where the encumbered asset is perishable or may decline in value rapidly, the notice is not required. Finally, and most importantly, the person in possession of the vans should not object to Bank Y taking possession of the vans. If the person objects, Bank Y will have no choice but to initiate a judicial enforcement process.

99. In the case where a security right was granted in a generic category of assets, the creditor is entitled to seize all such assets in order to enforce its security right, as each asset under that category secures the entirety of the obligation. However, if the creditor knowingly and with intent takes possession of several assets when the value

of one of the assets would be sufficient to secure the obligation, it may be considered contrary to the general standards of conduct provided in the Model Law.

3. Disposition of the encumbered asset

100. Once Bank Y is in possession of the vans, it would seek to determine the value of their value for the purposes of getting paid. The key objective of Bank Y would be to recover the loan to the extent possible through enforcement. As a financial institution, Bank Y would likely not have any intention to acquire the vans for its use. It is more likely that Bank Y would want to sell the vans as quickly as possible and at the highest possible price, to be reimbursed in full or in part based on the proceeds.

101. One possibility is to go ahead with the sale by applying to a court or other authority. The method, manner, time, place and other aspects of the sale would be pre-determined by the enacting State. While such public sale or court-supervised disposition may have its merits (in particular, for immovable property), it may not be particularly appropriate for sale of movable assets.

102. Another possibility would be for Bank Y to sell the vans without applying to a court. In this case, Bank Y could determine the method, manner, time, place and other aspects of the sale (including whether to dispose of the vans individually or altogether). In practical terms, there would need to be a well-functioning secondary market for Bank Y to easily sell the vans and guarantee that their full value is realized. While the possibility of extrajudicial disposition gives much flexibility to secured creditors, the following conditions need to be satisfied ensuring that any interested person is able to protect its own interests (art. 78).

103. The secured creditor is required to notify its intention to proceed with the extrajudicial sale to the following persons in advance of the sale (a period specified by the enacting State):

Grantor and the debtor

- Any person with a right in the encumbered asset that had informed the secured creditor of that right in writing before the notice was sent to the grantor
- Any other secured creditor that has registered a competing security right in the encumbered asset before the notice was sent to the grantor and
- Any other secured creditor that was in possession of the encumbered asset when the enforcing secured creditor took possession.

104. The notice should contain the following information:

- Description of the encumbered asset
- A statement of the amount owed to satisfy the secured obligation (including interest and reasonable cost of enforcement)
- A statement that persons with a right in the encumbered asset (including the grantor and debtor) may terminate the sale by paying what is owed to the secured creditor in full as well as reasonable enforcement cost (art. 75) and
- The date after which the encumbered asset will be sold and
- Time, place and conditions of the sale.

105. Such a notice would enable the grantor or other competing claimants to verify that the sale will take place under commercially reasonable conditions. If the sale does not take place under commercially reasonable terms, the secured creditor may be liable for damages caused by its breach. However, the grantor and other concerned parties cannot challenge the validity of the sale, unless it is proved that the buyer of the encumbered was aware that the sale violated the rights of the grantor or those concerned.

[*Note to the Working Group: The Working Group may wish to consider whether a sample template to be given by a secured creditor in disposing the encumbered asset should be prepared in addition to the above explanation.*]

4. Options other than disposition

106. It might not always be possible or desirable for the secured creditor to dispose of the encumbered asset. For example, the secondary market for the type of asset may not exist or it might not be so feasible to find a buyer. If it appears that the sale of the encumbered asset will be problematic or will not yield the best price, Bank Y may decide to use other methods. For example, Bank Y may decide to lease the vans and collect rental payments, which will be deducted from the amount due. Company X would retain ownership of the vans but would be deprived of the right to use it in its business operations. The same procedural safeguards for disposition of the encumbered asset would apply to such leasing arrangements by the secured creditor.

107. Bank Y may also offer to acquire the vans as full or partial satisfaction of the secured obligation. In other words, Bank Y would become the owner of the vans, the value of which would be used to offset the amount due. The advantage of this method is that the Bank Y can enjoy all the rights and powers attached to ownership of the vans and subsequently dispose of them freely. Company X may also request Bank Y to choose this enforcement method. In any case, this method of enforcement is also subject to procedural safeguards similar to that required in disposition (art. 80).

108. The proposal by the secured creditor to acquire the encumbered asset should be in writing and sent to the grantor, debtor and other persons with a right in the encumbered asset. The proposal should also contain the following information:

- A statement of the amount required to satisfy the secured obligation (including interest and reasonable cost of enforcement) at the time of proposal
- A statement of the amount of the secured obligation that is proposed to be satisfied
- Description of the encumbered asset
- A statement that persons with a right in the collateral (including the grantor and debtor) may terminate the acquisition by paying what is owed to the secured creditor in full as well as reasonable enforcement cost and
- The date after which the secured creditor would acquire the encumbered asset.

109. The conditions for acquisition by the secured creditor are slightly different depending on whether the acquisition is in full or partial satisfaction of the secured obligation. When it is in full satisfaction of the secured obligation, the secured creditor would acquire the encumbered asset, unless it receives an objection by any person entitled to receive the proposal within the specified period. However, when it is in partial satisfaction, the secured creditor would acquire the encumbered assets only if it receives the consent in writing of all persons entitled to receive the proposal within the specified period. If an objection was raised or consent was not received, the secured creditor would have to seek other options.

[*Note to the Working Group: The Working Group may wish to consider whether a sample template for proposing the acquisition of an encumbered asset should be prepared in addition to the above explanation.*]

5. Collection of payment

Example #25: Company X sells household appliances to home developers. Many of its sales are on credit, with developers paying for the appliance over a certain period. Company X needs operating funds from time to time to pay its ordinary expenses. Bank Y takes a security right over all of Company X's existing and future receivables and sets up a line of credit that Company X can draw on when it needs

funds. Company X defaults and Bank Y would like to enforce its security right over the receivables.

110. Where the collateral is a receivable, a negotiable instrument or a right to payment of funds in a bank account, enforcement by sale or disposition may not be as efficient. Therefore, the secured creditor is permitted to enforce its security right by collecting payment directly from the debtor of the receivable, the obligor under the negotiable instrument or the deposit-taking institution (art. 82). In example #25, Bank Y may collect payment from Company X's customers. However, the rights of Bank Y to collect payment would generally be subject to the provisions in the Model Law on rights and obligations of third-party obligors (arts. 61 to 71).

[*Note to the Working Group: A sample template detailing payment instructions will be prepared and included in the Annex.*]

111. While the Model Law generally applies to outright transfers of receivables, the provisions on enforcement are not applicable as there is no underlying secured obligation. An outright transferee of a receivable is entitled to collect the receivable at any time after payment becomes due (art. 83).

6. Terminating or taking over the enforcement process

Example #26: Company X has a printing business and takes a loan from Bank Y. Bank Y makes the loan and takes a security right over the printing press of Company X. Upon Company X's default, Bank Y plans to enforce its security right by selling the equipment in a public sale, and the sale has been advertised in local newspapers. However, a business partner of Company X is willing to advance money to repay the loan owed by Company X.

112. Any affected person (grantor, any other person with a right in the encumbered asset, or the debtor) may terminate the enforcement process by paying what is owed to the secured creditor in full and by reimbursing reasonable enforcement costs that the creditor may have incurred (for example, the cost for advertising in example #26). However, termination is no longer possible once the encumbered asset has been sold or disposed in the enforcement process, or once the secured creditor has entered into an agreement to sell or otherwise dispose of the encumbered asset, whichever may be earlier.

Example #27: Mr. X runs a restaurant and takes a loan from Bank Y. Bank Y takes a security right over the kitchen appliances of Mr. X and registers a notice in the Registry on 18 October 2018. Bank Y provides the loan for a one-year period on 20 October 2018. Mr. X requires additional operating expenses and takes a loan from Bank Z. Bank Z makes the loan for the value of the kitchen appliances in excess of the loan provided by Bank Y for a three-month period and registers a notice in the Registry on 1 December 2018. On the expiry of the three-month period, Mr. X is not able to repay its loan.

113. In example #27, while Mr. X might be in default with respect to its obligation to Bank Z, it is not so with respect to its obligation to Bank Y as Bank Y's claim is not yet due. Bank Z's security right does not have priority over Bank Y's security right as it was registered later. In this example, Bank Z has the right to commence enforcement, but would be subject to the rights of Bank Y.

114. In order to protect its rights, a creditor whose security right has priority as against that of the enforcing secured creditor is entitled to take over the enforcement procedure at any time before it comes to an end. Therefore, while Bank Z may commence enforcement, Bank Y could take over enforcement even if its claims against Mr. X is not yet due. To ensure this, secured creditors should include enforcement by third parties as constituting default in the security agreement (see section D).

7. Distribution of proceeds & rights of the buyer or other transferees

Example #28: In example #27, Bank Y takes over enforcement and sells the kitchen appliances for an amount of 150,000 USD to Ms. V. Bank Y had loaned 100,000 USD to Mr. X and had spent 10,000 USD on expenses related to the sale. Bank Z is owed 50,000 USD.

115. If the encumbered asset was sold through a judicial disposition, the relevant rules in that State would determine how proceeds are distributed, while the provisions of the Model Law on priority would continue to apply.

116. In example #28, as the kitchen appliances were sold by Bank Y, Bank Y is responsible for distributing the proceeds. Enforcement of a security right should not be a source of enrichment and thus a secured creditor must apply the proceeds to what it is owed after deducting the reasonable cost of enforcement. Afterwards, it must pay the surplus to any subordinate competing claimant that had notified the secured creditor of its claim and the claim amount. If any balance is remaining, it should remit the balance to the grantor (art. 79).

117. Accordingly, Bank Y would deduct 10,000 USD as enforcement cost and apply 100,000 USD as amount owed to it. This would generally extinguish Bank Y's security right as the secured obligation is fully satisfied (unless there were outstanding commitments by Bank Y to extend credit). Bank Y would then disburse 40,000 USD to Bank Z, whereas it is owed 50,000 USD.

118. The buyer of the encumbered asset would take the asset free of any security right, except those that have priority as against the security right of the enforcing secured creditor (art. 81(3)). Ms. V would take the kitchen appliances free of any security right, unless there was a person with a right having priority over Bank Y's security right. Any other competing claimants whose rights have a lower priority than that of Bank Y (for example, Bank Z) can no longer exercise any right on the kitchen appliances sold to Ms. V. This provides a safeguard for buyers and other transferees who take part in the enforcement process.

119. Buyers should, however, carefully examine whether there are any higher-ranking security rights when they purchase encumbered assets from the enforcing secured creditor. Suppose that Bank Y did not take over the enforcement process and Bank Z had conducted the sale of the kitchen appliances to Ms. V at the price of 150,000 USD. Unless the proceeds of the sale are used to discharge Mr. X's secured obligation to Bank Y, Ms. V would take the asset free of Bank Z's security right but would continue to be subject to Bank Y's security right as it had priority over Bank Z. This suggests that it will be very rare to see a lower-ranking secured creditor take the initiative of disposing encumbered assets, as a buyer is unlikely to accept the risk of taking over an asset that is still subject to another security right.

I. What to do during the transition to the Model Law

120. The Model Law provides for fair and efficient transition rules from prior law (arts. 101–106). Before the entry into force of the new law based on the Model Law (referred to in this section simply as the "new Law"), parties may have agreed to create a right over a movable asset. If that right falls within the meaning of "security right" under the new Law and the new Law would have applied had it been in force, that right is recognized as a "prior security right" under the new Law. The law(s) that applied to prior security rights before the entry into force of the new Law is referred to as "prior law".

121. Given the diversity of prior laws, the following provides a general overview of how the new Law operates. Parties should also examine provisions of prior laws that may have been repealed as they may still be applicable under certain circumstances.

In general, the new Law applies also to prior security rights if they fall within the scope of the new Law. There are, in broad, two exceptions to this general rule.

122. The first exception is that the prior law might apply. This is when proceedings before a court or arbitral tribunal have commenced before the entry into force of the new Law. The prior law also applies when a determination has to be made whether the prior security right was properly created. Moreover, the prior law would determine the priority among a prior security right and rights of competing claimants, which arose before the new Law and the status of which have not changed (art. 106).

123. There are some practical considerations to be taken into account by secured creditors. Even if any step had been taken to enforce a prior security right before the entry into force of the new Law, the enforcing secured creditor can choose whether the enforcement will continue under prior law or the new Law (art. 103(2)). Considering that the new Law provides an effective enforcement mechanism, secured creditors may wish to proceed under the new Law. As mentioned above, the creation of a prior security right is determined by the prior law. There may be instances where the prior security right was effectively created under the prior law but did not meet the requirements under the new Law (though this would be rare as the creation requirements under the new Law are minimal). In such case, a secured creditor may wish to satisfy the creation requirements under the new Law, as the prior security right would only be effective between the parties.

124. The second exception is that the third-party effectiveness (and priority) of prior security rights under the prior law is preserved even after the new Law has entered into force. However, secured creditors should be aware that this is only for a certain period. The new Law may specify a period after which the third-party effectiveness will expire and this period may be shorter than the third-party effectiveness period that would have been recognized under the prior law.

125. Therefore, it would be practical for secured creditors to take steps to extend the third-party effectiveness of their security rights. This can be done simply by satisfying the third-party effectiveness requirements of the new Law. For example, if the secured creditor registers a notice in the Registry, the prior security right would continue to be effective against third parties as of the time it was made effective against third parties under prior law. If the secured creditor does not satisfy the third-party effectiveness requirements of the new Law before the third-party effectiveness expires, the prior security right will only be effective from the time the requirements are met.

126. In summary, parties should be aware that the prior law may sometimes be applicable even though the new Law has entered into force. While the new Law preserves the rights of creditors under prior law to a certain extent, it is also advisable that creditors ensure that the creation and third-party effectiveness requirements under the new Law are met to ensure their rights under the new Law.

Example #29: In 2015, a car-financing Company Y provides funding to Company X and enters into an agreement to take security over the automobiles that Company X purchased. It makes its rights effective against third parties by registering a notation in the Motor Vehicles Registry for some cars but also registers itself as the owner for other cars. The notations registered in the Motor Vehicles Registry is valid for 5 years. In 2017, the new Law is passed to enter into force on 1 January 2018. Notations in Motor Vehicles Registry are no longer recognized as a method of achieving third-party effectiveness. The new Law also states that the third-party effectiveness obtained under prior law will expire one (1) year after the entry into force of the new Law.

127. In example #29, Company Y will first want to make sure that its rights over the automobiles were properly created under the prior law and that the creation requirements of the new Law have been complied with. As the third-party effectiveness obtained under prior law would expire on 31 December 2018, Company

Y may also want to register a notice in the Registry so that its prior right continues to be effective against third parties from the time it registered in the Motor Vehicles Registry. This would generally ensure that Company Y has priority over competing claimants with rights that arose after the new Law. However, priority against competing claimants with rights that arose before the new Law would be determined by the prior law. If the transitional period lapses and Company Y has not taken the steps mentioned above, it may lose its priority over the automobiles.

128. If a court proceeding had commenced before 1 January 2018, the prior law would apply. Even if Company Y had obtained possession of the automobiles in November 2017 due to an event of default by Company X, Company Y could proceed with the enforcement in accordance with the new Law, if it is more favourable. Enforcement initiated after 1 January 2018 would proceed under the new Law.

J. Issues arising from cross-border transactions

129. Much of the content in this Guide assumes that the secured transactions take place entirely within a State that has enacted the Model Law. This means that the parties as well as the encumbered assets are located in a single State and that the Model Law would govern the transactions.

130. However, if the transaction is connected to more than one State ("cross-border transaction"), parties may need to take appropriate action depending on which State's law applies. Therefore, parties would need to determine which State's law would govern the following issues:

- The creation of a security right
- The third-party effectiveness of a security right
- The priority of a security right as against competing claimants and
- The enforcement process.

131. Rules that determine which State's law would govern in cross-border transactions are often referred to as "conflict-of-laws" rules. Each State usually has its own conflict-of-laws rules and if a court proceeding were to take place, the court would apply the rules of that State to identify the law that would be applicable. This would also be the case when insolvency proceedings take place. Considering the wide variance of approaches in different States, it would be difficult to illustrate all possible scenarios. For the sake of simplicity and in line with the general approach of this Guide, this section assumes that the all of the relevant States have adopted the conflict-of-law provisions of the Model Law.

132. The following provides a summary of the conflict-of-laws rules of the Model Law that determine which State's laws apply to the most important aspects of a secured transaction.

133. Parties should be mindful that the conflict-of-laws rules of the Model Law on the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right are mandatory. Thus, parties cannot change the law applicable to these issues by designating a different law in their agreement. However, the parties are free to choose a different law on issues relating to the obligations between the secured creditor and the grantor (art. 84).

134. Parties may seek to exercise control over where litigation takes place by inserting a "choice-of-forum" clause that purports to grant exclusive jurisdiction over any dispute arising from their security agreement to the courts of a designated State. Although this may serve as an effective mechanism as between the secured creditor and the grantor, a choice-of-forum clause is unlikely to be effective to displace the jurisdiction of the courts of other States if the litigation involves the rights of third parties or if insolvency proceedings are commenced by or against the grantor in a different State.

1. An overview of the conflict-of-laws rules in the Model Law

Creation

135. The law that would determine whether a security right has been effectively created differs depending on whether the assets to be encumbered are tangible or intangible. For tangible assets, one must refer to the law of the State where the assets are located. For intangible assets, one must refer to the law of the State where the grantor is located. In both instances, the relevant time of determining the location of the assets and of the grantor is the time the security right was intended to be created.

Third-party effectiveness and priority

136. Similarly, whether a security right in an encumbered asset is effective against third parties and has priority against competing claimants is determined: (i) in the case of tangible assets, by the law of the State where the assets are located; and (ii) in the case of intangible assets, by the law of the State where the grantor is located.

137. Unlike creation, the relevant time for determining the location is the time when the issue arises. Since assets can be moved and grantors can change their location from one State to another, the applicable law may change over the course of a transaction. Thus, secured creditors should continuously monitor the location of the encumbered assets and the grantor as a change in the applicable law can necessitate protective action on the part of a secured creditor, for example, registering a notice in another State's Registry (art. 23).

Enforcement

138. The law that governs the enforcement process of a secured creditor also differs depending on whether the encumbered assets are tangible or intangible. For tangible assets, the law of the State of where the assets are located at the time that the enforcement process starts is applicable. For intangible assets, the law of State where the grantor is located applies.

139. The above explanation is a very simplified overview and does not address every issue for every type of encumbered asset. For example, special conflict-of-laws rules apply to certain types of encumbered assets. With respect to funds credited to a bank account, the conflict-of-laws rules of the Model Law will often lead to the application of the law of the State where the bank account is maintained (art. 97(1), option A). The Model Law also provides special conflict-of-laws rules for the following types of assets:

- Tangible assets covered by a negotiable document (art. 85(2))
- Tangible assets of a type ordinarily used in more than one State (art. 85(3))
- Goods in transit (art. 85(4))
- Intellectual property (art. 99) and
- Non-intermediated securities (art. 100).

140. Parties considering to enter into cross-border transactions may therefore wish to obtain legal advice addressing the specificities of their transaction.

2. Practical examples

141. The following are some illustrations of how the conflict-of-laws rules in the Model Law would operate.

Example #30: Company X is a distributor of computers administrating its business from an office located in State A. Company X offers computers for sale in stores in State A and in State B. Company X wishes to grant to Bank Y located in State C, a security right in the computers held as inventory in all its stores.

142. In example #30, the law applicable to the creation and third-party effectiveness of Bank Y's security right is that of the State where the inventory of computers is located. Therefore, for Bank Y's security right to be valid and effective against third parties, Bank Y will need to fulfil the requirements of the law of State A with respect to the computers in State A, and the law of State B with respect to the computers in State B.

Example #31: Company X is a distributor of computers administrating its business from an office located in State A. Company X sells on credit computers held as inventory in stores in State A and State B to customers located in States A and B and in other States. Company X wishes to grant to Bank Y, located in State C, a security right in all present and future receivables generated from its sale of computers.

143. In example #31, the law applicable to the creation and third-party effectiveness of Bank Y's security right is that of the State where the grantor (Company X) is located. For the purposes of the conflict-of-law rules, the location of the grantor is: (i) the State where it has its place of business (States A and B) and (ii) if the grantors has places of business in more than one State, the State where its central administration is exercised (State A). Therefore, Bank Y would need to fulfil the requirements of the law of State A for its security right in the receivables owing to Company X to be valid and effective against third parties. This would be regardless of the fact that the customers of Company X may be located in States other than State A.

Example #32: Company X maintains a bank account with a bank in State A and a bank account with another bank in State B. Company X deposits to these accounts the amount received from the collection of its receivables. Company X wishes to grant a security right in the funds credited to both bank accounts to Bank Y, located in State C.

144. In example #32, if State C implements option A of article 97, the law applicable to the creation and third-party effectiveness of Bank Y's security right would be the law of the State where the bank accounts are maintained. Bank Y will need to fulfil the requirements of the law of State A (for the bank account maintained in State A), and the law of State B (for the bank account maintained in State B), for its security right in both bank accounts to be recognized in State C as valid and effective against third parties.

145. As illustrated above in examples # 30 to #32, the location of the secured creditor is not relevant for the determination of the applicable law under the conflict-of-law rules of the Model Law. Therefore, whether the secured creditor (Bank Y) is located in a State that has enacted the Model Law or not has no impact on that determination.