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Report of Working Group VI (Security Interests) on the work of its seventh session (New York, 24-28 January 2005)

Contents

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I. Introduction

1. At its present session, Working Group VI continued its work on the preparation of a legislative guide on secured transactions pursuant to a decision taken by the Commission at its thirty-fourth session, in 2001.[1] The Commission's decision to undertake work in the area of secured credit law was taken in response to the need for an efficient legal regime that would remove legal obstacles to secured credit and could thus have a beneficial impact on the availability and the cost of credit.[2]

II. Organization of the session

2. The Working Group, which was composed of all States members of the Commission, held its seventh session in New York from 24 to 28 January 2005. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Austria, Belarus, Canada, China, Colombia, Czech Republic, France, Germany, Guatemala, India, Italy, Japan, Madagascar, Mexico, Nigeria, Poland, Republic of Korea, Russian Federation, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Turkey, Uganda, United States of America and Zimbabwe.

3. The session was attended by observers from the following States: Afghanistan, Cuba, Dominican Republic, Ethiopia, Holy See, Hungary, Ireland, Malaysia, Peru, Philippines and Senegal.

4. The session was also attended by observers from the following international organizations:

(a) United Nations system: International Monetary Fund, World Bank and World Intellectual Property Organization (WIPO);

(b) Intergovernmental organizations: Council of the Inter-Parliamentary Assembly of Member Nations of the Commonwealth of Independent States (CIS IPA), Hague Conference on Private International Law; and

(b) International non-governmental organizations invited by the Commission: American Bar Association (ABA), Center for International Legal Studies (CILS), Commercial Finance Association (CFA), International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL), International Chamber of Commerce (ICC), International Credit Insurance & Surety Association (ICISA), International Insolvency Institute (III), International Working Group on European Security Rights, Max-Planck-Institute for Foreign and Private International Law (MPI), the European Law Student's Association (ELSA), the Association of the Bar of the City of New York (ABCNY) and Union of Industrial and Employers' Confederations of Europe (UNICE).

5. The Working Group elected the following officers:

Chairman: Ms. Kathryn SABO (Canada)

Rapporteur: Mr. Sung-Keun YOON (Republic of Korea)

6. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.14/Add.1 (Priority), A/CN.9/WG.VI/WP.16 and Add.1 (Recommendations), A/CN.9/WG.VI/WP.17 and Add.1 (Acquisition financing devices), A/CN.9/WG.VI/WP.18 and Add.1 (Security rights in bank accounts) and A/CN.9/WG.VI/WP.19 (Conflict of laws).

7. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Preparation of legislative guide on secured transactions.
5. Other business.
6. Adoption of the report.

III. Deliberations and decisions

8. The Working Group considered chapters X (Conflict of Laws), XII (Acquisition financing devices) and XVI (Security rights in bank accounts). The deliberations and decisions of the Working Group are set forth below in chapters IV and V. The Secretariat was requested to revise those chapters to reflect the deliberations and decisions of the Working Group.

IV. Preparation of a legislative guide on secured transactions

Chapter X. Conflict of laws (A/CN.9/WG.VI/WP.16/Add.1, Recs. 100-116 and A/CN.9/WG.VI/WP.19)

A. Recommendations

Purpose section

9. There was general agreement in the Working Group with the purpose section and the premise that the conflict-of-laws rules needed to be clear, easy to apply, pragmatic and meeting the needs of modern secured finance.

Recommendations 100 (possessory security rights in tangible property) and 101 (non-possessory security rights in tangible property)

10. While there was general agreement in the Working Group with the substance of recommendations 100 and 101, differing views were expressed as to whether they should be merged. One view was that, although they both provided for the application of the law of the location of the assets (*lex rei sitae*), recommendations 100 and 101 should not be merged. It was stated that the distinction should be preserved for reasons of consistency in the guide. In addition, it was observed that the distinction was justified since, assuming that possession

meant actual possession (see A/CN.9/WG.VI/WP.16, recommendation 31), a possessory security right in mobile goods, goods in transit and export goods was not possible.

11. However, the prevailing view was that recommendations 100 and 101 should be merged. It was stated that no distinction should be made where a single rule could apply to both possessory and non-possessory security rights. It was also said that while a possessory security right in mobile goods, goods in transit and export goods was rare, it was possible and thus the special rules in the second sentence of recommendation 101, and in recommendations 104 and 105 should apply to both possessory and non-possessory security rights. After discussion, it was agreed that recommendations 100 and 101 should be merged and include a cross-reference to the special rules on mobile goods, goods in transit and export goods (while the meaning of those terms should be clarified in the commentary).

12. In that connection, the Working Group considered the character of recommendations 104 and 105 and agreed that they appropriately provided the secured creditor with the alternative of taking the steps to create a security right as between the parties and to make it effective as against third parties under the law of the State of the ultimate destination (see paras. 17 and 18 below).

13. With respect to the note after recommendation 102, it was agreed that the discussion be deferred until the Working Group had the opportunity to consider the subject of security rights in negotiable instruments and negotiable documents on the basis of a report by the Secretariat.

Recommendation 103 (proceeds)

14. The Working Group noted that if a security right in the original encumbered assets (e.g. inventory) was created in State A and a security right in the proceeds (receivables) was created in State B where the receivables arose, under alternative A, the law governing the creation, third-party effectiveness and priority of the security right in the receivables would be the law of State B, while, under alternative B, the law governing the creation of the security right in the receivables would be the law of State A and the law of governing third-party effectiveness and priority of that right would be the law of State B.

15. In support of alternative A, it was stated that it subjected issues of creation, third-party effectiveness and priority of security rights in proceeds to a single law. Thus, it was observed, alternative A avoided creating problems in the application of the rule in States that did not distinguish between creation of the security right as between the parties and its effectiveness against third parties and discriminating against creditors in countries that did not recognize an automatic security right in proceeds. On the other hand, it was stated that alternative A would create uncertainty as to the law applicable to proceeds, since: the creation of a security right in proceeds would be different from the law governing the creation of the security right in the original encumbered assets; that law would be very difficult to determine at the time of the creation of the security right in the original encumbered assets; and more than one applicable law would be involved in cases where proceeds arose in several countries.

16. The prevailing view was that alternative B was preferable. It was observed that alternative B enhanced certainty as to the law applicable to proceeds, since it

provided for the application of a single law to issues relating to the creation of a security right in both the original encumbered assets and their proceeds and of a law that could be easily determined at the time of the creation of the security right in the original encumbered assets. It was also said that alternative B was consistent with the substantive law recommendation 13 (A/CN.9/WG.VI/WP.16) that provided that the security right in proceeds arose from the security right in the original encumbered assets and respected the normal expectations of the parties. After discussion, the Working Group decided to delete alternative A and to retain alternative B.

Recommendations 104 (goods in transit) and 105 (export goods)

17. The Working Group noted that, under recommendations 104 and 105, a security right in goods in transit and export goods could be created as between the parties and made effective against third parties not only according to the law of the initial location of the goods (under recommendations 100 and 101) but also under the law of the State of their ultimate destination. It was also noted that priority remained, under recommendations 100 and 101, subject to the law of the location of the goods at the time the priority conflict arose (see recommendation 107).

18. There was general agreement in the Working Group with the substance of recommendations 104 and 105. As to the formulation of recommendation 105, it was agreed that reference should be made consistently to the law of the State of the ultimate destination of the goods and to the creation of a security right "as between the parties" (and not to creation in general). A suggestion to limit the scope of recommendation 105 to goods exported to the grantor only did not attract sufficient support as it would unnecessarily exclude, for example, situations where goods were shipped by the grantor to another party.

Recommendations 106 (location), 107 (relevant time when determining location) and 108 (continued third-party effectiveness upon change of location)

19. There was general support in the Working Group for the substance of recommendations 106, 107 and 108. It was also agreed that, because of its importance for the conflict-of-laws recommendations of the guide, recommendation 106 should be retained in that chapter.

20. A suggestion to delete recommendation 107 did not attract sufficient support. It was stated that recommendation 107 was important since it provided a basic rule as to the time when location of the assets or the grantor should be determined. It was explained that the relevant time was not the same for creation and third-party effectiveness, since creation involved a single point of time while third-party effectiveness could be achieved at one time and lost thereafter. It was also said that the concern as to the exact meaning of the expression "time of creation", which was a matter of the applicable substantive law and was discussed in the chapter of the guide dealing with the creation of the security right as between the parties, could be addressed in the commentary. It was also observed that the exact meaning of the expression "the issue arises" could also be explained in the commentary by reference to specific examples (e.g. the relevant time for determining the law applicable to third-party effectiveness of a security right in the case of the insolvency of the grantor should be the time of commencement of the insolvency proceeding).

Recommendation 109 (*renvoi*)

21. There was general agreement in the Working Group with the substance of recommendation 109. As to its formulation, the suggestion to replace the words "conflict of laws" with the words "choice of law" in order to avoid inadvertently covering issues such as the issue of characterization, did not attract sufficient support. It was stated that the expression "conflict of laws" was widely used and easily understood, while the expression "choice of law" could be misunderstood as meaning choice of law by the parties. Because of its importance for the conflict-of-laws recommendations of the guide, it was agreed that recommendation 109 could be retained in that chapter.

Recommendation 110 (competing claimant)

22. There was general support in the Working Group for the substance of recommendation 110. As to its formulation, it was agreed that: discussion of paragraph (a bis) should be postponed until the Working Group considered the chapter on acquisition financing; in paragraph (c), reference should be made to the "insolvency representative"; and in paragraph (d), which should be retained without the square brackets, reference should be made to "a buyer or any other transferee" of the encumbered assets. As recommendation 110 included the definition of a term used in other chapters of the guide, it was agreed that it should be placed in chapter I with the other definitions of the guide.

Recommendation 111 (extent of party autonomy with respect to governing law)

23. It was noted that recommendation 111 was intended to recognize the freedom of the parties to choose the law applicable to their rights and obligations as between them arising from the security agreement before default. As the expression "mutual rights and obligations of the parties" had been taken from article 28 of the United Nations Assignment Convention which in turn originated from article 12 (1) of the Rome Convention on the Law Applicable to Contractual Obligations, it was noted that recommendation 111 covered in principle contractual issues. There was general support in the Working Group for that understanding of the substance of recommendation 111.

Recommendation 112 (law governing the mutual rights and obligations of the parties in the absence of agreement of the parties)

24. It was agreed that, in the absence of a choice of law by the parties, their mutual rights and obligations arising from the security agreement should be governed by the law governing the security agreement. It was stated that such an approach was appropriate, since the mutual rights and obligations of the parties arose from the security agreement and was clearer than the similar expression "the law of the State with which the security agreement is most closely connected".

Recommendation 113 (substantive enforcement matters)

25. Support was expressed for alternatives A (law of the forum), C (law governing the contractual relationship of the parties) and D (law governing the mutual rights and obligations of the parties).

26. In favour of alternative A, it was stated that application of the law of the forum to enforcement matters was appropriate since it would result in the application of the law governing remedies (and thus render unnecessary the distinction between procedural and substantive enforcement matters), the law of the likely location of the assets and the law which parties would expect to be applicable. It was also observed that alternatives C and D created uncertainty, as third parties could not easily ascertain what law governed the contractual relationship or the mutual rights and obligations of the parties to a specific security agreement, and could result in the application of more than one law in situations where enforcement was sought by more than one creditor.

27. The suggestion was also made that alternative A could be revised to provide that, while enforcement should be subject to the law of the forum, the effectiveness and priority of a security right under other law should be respected in the same way they would be respected under recommendations 115 and 116 in the case of enforcement in the insolvency of the grantor.

28. In favour of alternatives C and D, it was observed that they treated enforcement issues as part of the bargain between the secured creditor and the grantor, and referred them to the law of a single and easily determinable jurisdiction. That was said to enhance certainty for the secured creditor with respect to the law applicable to the most important matter for which the security right was created, i.e. the protection of the secured creditor in the case of default. It was also said that alternative A would create uncertainty, as parties could not easily determine at the time of the conclusion of the security agreement where enforcement might take place and as enforcement involved various steps that could be subject to more than one law if the encumbered assets were in different countries.

29. As between alternatives C and D, one view was that alternative D was preferable since it avoided the distinction between substantive and procedural enforcement issues and referred more directly to specific enforcement steps. Another view was that alternative C was preferable since it appropriately referred to the mandatory rules of the forum in general, without highlighting specifically the need for the consent of the grantor (or other person in possession of the assets) to be obtained in the case of extrajudicial enforcement.

30. After discussion, it was agreed that alternative A should be retained along with a variation consistent with the approach taken in the case of enforcement in the insolvency of the grantor. It was also agreed that alternatives C and D or a combination thereof should also be retained.

Recommendation 114 (procedural enforcement matters)

31. The Working Group noted that recommendation 114 would not be necessary if alternative A or alternative D of recommendation 113 were adopted.

Recommendations 115 (impact of insolvency on conflict-of-laws rules) and 116 (enforcement in insolvency proceedings)

32. Due to the lack of sufficient time, the Working Group decided to postpone discussion of recommendations 115 and 116.

B. General remarks

33. Having completed its discussion of the recommendations, the Working Group requested the Secretariat to adjust the general remarks of the chapter on conflict of laws to the recommendations.

Chapter XII. Acquisition financing devices (A/CN.9/WG.VI/WP.17 and Add.1)

A. General remarks

34. The Working Group confirmed its decision in favour of a functional approach (see A/CN.9/WG.VI/WP.16, rec. 6), according to which all devices performing security functions would be covered in the guide. In addition, the Working Group agreed that the functional approach could be implemented either by integrating under a single notion of security right all devices performing security functions and subjecting them to the rules of the secured transactions law ("integrated approach") or by preserving the various forms of devices performing security rights without subsuming them into a unitary notion of security right but subjecting them to certain rules of secured transactions law ("non-integrated approach"). It was stated that States with a developed legal system and a mature credit economy might prefer the non-integrated approach (which would require some coordination between secured transactions and other law), while other States that were not concerned about revising other law and needed to develop a credit economy might prefer the integrated approach (which might be easier to implement).

35. Moreover, it was widely felt that the guide needed to treat all the possible providers of acquisition financing equally so as to enhance competition that should decrease the cost and increase the availability of credit. At the same time, it was agreed that the importance of retention of title and financial leases should be emphasized, in particular for small- and medium-size businesses, for which suppliers and lessors might be, in some economies, the main or even the only affordable source of credit. It was also generally understood that the guide should focus on the rights and obligations of the parties and on ensuring certainty and transparency in that regard rather than on determining which creditor was the owner of an asset.

36. After a discussion of the key points that should be emphasized in the general remarks, the Working Group proceeded to discuss the recommendations.

B. Recommendations

Recommendation 1 (equivalence of acquisition financing devices to security rights)

37. While some preference was expressed for one or the other approach, it was generally agreed that both the integrated and the non-integrated approach should be recommended to States. At the same time, it was widely felt that recommendation 1 should be revised to better reflect the two approaches. As to the terminology,

preference was expressed for the general term "acquisition financing" to cover retention of title, purchase-money lending arrangements and financial leases. The Working Group deferred consideration of the question of the placement of the recommendations relating to acquisition financing in the guide until it had completed its consideration of those recommendations.

Recommendation 2 (creation of acquisition security rights as between the parties)

38. While recommendation 2 received sufficient support, a number of concerns were also expressed. One concern was that, by failing to require a signed writing, recommendation 2 could create uncertainty and litigation. In response, it was stated that recommendation 2 accomplished its policy objectives to provide certainty with respect to the creation of an acquisition security right, while at the same time accommodating the needs of retention-of-title and similar practices. It was observed, however, that if signature was not required, that could increase the due diligence costs which the secured creditor would pass on to the borrower, a matter that needed to be clarified in the commentary on recommendation 2. For that reason, it was widely felt that recommendation 2 should not apply to non-acquisition security rights.

39. Another concern was that, by requiring some form of writing, recommendation 2 was inconsistent with the United Nations Convention on Contracts for the International Sale of Goods (CISG), which required no writing. In response, it was observed that recommendation 2 dealt with the retention-of-title agreement, the security agreement and the financial lease agreement, and not with the sales contract.

40. Yet another concern was that, while recommendation 2 might be appropriate if a State adopted an integrated approach, it might not be sufficient if a State adopted a non-integrated approach. It was mentioned, for example, that the term "grantor" might be confusing in the context of sales or other law, under which both the seller and the buyer had ownership rights and no one granted to the other a security right. It was also pointed out that the impact of recommendation 2 on sales or other law was not clear, as recommendation 2 did not specify the consequences of the failure of the seller to meet the form requirements of recommendation 2. In response, it was said that, as recommendation 2 introduced a very low threshold, it would be met in most commercial sales transactions with retention-of-title clauses.

41. However, it was agreed that, in order to address that concern, the recommendation or the commentary should clarify the consequences of the failure of the seller to meet the form requirements of recommendation 2. With respect to the exact nature of these consequences, differing views were expressed. One view was that title should pass to the buyer who should then be able to grant a security right in the goods to a third party. Another view was that, as the sales contract might be null and void as a result of the invalidity of the retention-of-title agreement which would be of the essence for the sales contract, title would remain with the seller. As a result, if the buyer had given any security rights in the goods to third parties, these security rights would be non-existing, as the buyer would have no right in the encumbered assets.

42. Yet another view was that, if the form requirements of recommendation 2 were not met and the buyer granted a security right to a third party that took all the

necessary steps to obtain an effective and enforceable security right, the secured creditor's claim would have priority over the claim of the seller. It was stated that the guide did not need to interfere with sales and property law and go as far as to suggest that title passed to the buyer (which was not necessary as the buyer could grant a security right even without being an owner; see recommendation 12 in A/CN.9/WG.VI/WP.16).

43. In addition, it was said that considering that title remained with the seller would undermine the whole regime envisaged in the guide, as a secured creditor that would have followed all the rules recommended in the guide would be deprived of its priority. There was sufficient support in the Working Group for the discussion of these matters in the commentary on recommendation 2. There was also sufficient support for the suggestion that the commentary should alert States that there might be an impact on their sales or property law even if they adopted a non-integrated approach.

44. In that connection, it was stated that the discussion of the consequences of the failure of the parties to meet the form requirements set out in recommendation 2 (see paras. 40-43 above) had shown the difficulty of following a non-integrated approach and should lead the Working Group to reconsider its position to recommend two alternative approaches. In response, it was observed that the problem of the consequences of non-compliance with form requirements would be resolved if no form requirements were imposed for the creation of an acquisition security right.

45. After discussion, the Working Group generally agreed with the substance of recommendation 2. It was also agreed that the commentary should discuss the impact of recommendation 2 in the context of an integrated and a non-integrated approach to secured transactions law. In addition, while it was widely felt that the threshold of the form requirements under recommendation 2 was so low that most commercial sales transactions with retention-of-title clauses, purchase-money lending arrangements and financial leases would meet it, it was agreed that it would be useful for the commentary to discuss the consequences of the failure of the acquisition financier (i.e. the seller, the purchase-money lender or the financial lessor) to meet those form requirements.

Recommendation 3 (effectiveness of acquisition security rights against third parties)

46. While the substance of recommendation 3 was found to be generally acceptable, a number of suggestions were made. One suggestion was that the grace period should be longer than 20 or 30 days. It was stated that, in situations where a paper-based registry or a registry in another country was involved, a grace period of 50 or 60 days would be more appropriate. It was observed that, in all those situations, the acquisition financier would need time to familiarize itself with the registration requirements, obtain legal advice as to the foreign law and work its way through an unknown foreign bureaucracy. That suggestion was objected to. It was stated that the grace period constituted a compromise in the sense that additional credit to a buyer, grantor or financial lessee would be delayed to protect the interests of the acquisition financier. It was also stated that, in a paper-based system, a grace period of 20 or 30 days would be sufficient, while, in an electronic system in which users could register directly from their computers without any intervention from the

registry, the grace period should be much shorter (2-3 days). It was pointed out, however, that each State would have to determine the exact length of the grace period, taking into account local circumstances, needs and capabilities. After discussion, it was agreed that the commentary should elaborate on the considerations for determining the length of the grace period and the recommendation should refer to a grace period that would be as short as possible under the circumstances prevailing in the enacting State.

47. Another suggestion was that the starting point of the grace period (i.e. the time of delivery of possession of the goods) should be further clarified. There was sufficient support for that suggestion. It was stated that, in line with the recommendations of the guide on creation as between the parties and effectiveness as against third parties of a security right, reference should be made to delivery of actual possession of the goods. However, it was widely felt that the recommendation should not go any further as the exact meaning of delivery was a matter of sales law. A related suggestion was that, in situations in which a person was in possession of the goods in another capacity, the grace period should start when that person became a buyer, a grantor or a financial lessee. There was sufficient support for that suggestion.

48. Yet another suggestion was that the registration should be effective at the time the notice was submitted to the registry and not at the time the notice was made available by the registry to searchers. While support was expressed for that suggestion, it was noted that the time of effectiveness of the registration was a general matter that should be dealt with in the chapter on effectiveness of a security right against third parties.

49. Yet another suggestion was that the consequence of the failure of the acquisition financier to register a notice about the acquisition security right in the secured transactions registry should be discussed in the commentary both in the context of an integrated and a non-integrated approach. That suggestion attracted sufficient support.

Recommendation 4 (exceptions)

50. There was support in the Working Group for an exception from the principle of registration for acquisition finance transactions relating to consumer goods, i.e. goods bought by individuals for personal, family or household purposes (recommendation 4 (a)). The concern was expressed, however, that in its current formulation the exception for transactions relating to consumer goods made it necessary for the legislator to monitor and amend the value of consumer goods transactions that should not be exempted. In order to address that concern, it was suggested that reference should be made to consumer goods with a resale value, coupled by an indicative list of such items as vehicles, aircraft, boats, trailers and the like. It was stated that, under such an approach, transactions in small-value consumer goods would be exempted from registration since there was no market for the financing of the resale of such consumer goods. It was also observed that high-value consumer goods subject to a title registry, such as motor vehicles, would also be exempted from registration in the secured transactions registry.

51. With respect to the exceptions from the principle of registration for small-value and short-term transactions (recommendation 4 (b) and (c)), differing views

were expressed as to whether they should be retained. One view was that these exceptions should be retained since they helped avoid burdening parties with unnecessary formalities and registries with excessive information. As to the small-value exception, it was suggested that the value should be fixed at a realistic level to protect transactions in which registration was unnecessary. With regard to the short-term exception, it was suggested that the term should be fixed at 180 days.

52. The prevailing view, however, was that these exceptions should be deleted. It was stated that an exception relating to the amount of the secured obligation or the time of payment would make it necessary for the legislator to monitor and revise the amount and would introduce complexity and litigation as the amount and the time payment would change from time to time. In addition, it was observed that the exception for transactions relating to consumer goods was sufficient to exclude small-value transactions and the grace period was sufficient to exclude short-term transactions. Moreover, it was said that an exception for short-term transactions would be very difficult to implement, in particular in inventory-related transactions in which the turnover involved a few days but could not be determined with certainty as the financier financed on the basis of invoices and could not monitor the actual movement of inventory on a daily or short-time basis. It was also mentioned that the exception for short-term or small-value transactions would be prone to manipulation, since parties to long-term or high-value financing arrangements could structure their relationship in short terms or small amounts to avoid registration. After discussion, the Working Group agreed that the exceptions for small-value and short-term transactions should be deleted.

Recommendation 5 (priority of acquisition security rights over pre-existing non-acquisition security rights in future goods other than inventory)

53. The Working Group agreed with the substance of the recommendation that the acquisition security right should have priority over a pre-registered non-acquisition security right in future goods other than inventory if the acquisition financier retained actual possession of the goods or registered a notice within the specified grace period after delivering the goods to the buyer, grantor or financial lessee, or if the acquisition transaction was not subject to registration according to recommendation 4. It was agreed that reference should be made to a pre-registered (rather than to a pre-existing) non-acquisition security right, since, as advance registration was possible, such a right could be created even after registration took place. It was also agreed that reference should be made to delivery of actual possession to the buyer, grantor or financial lessee acting in that capacity (see para. 47 above).

Recommendation 6 (priority of acquisition security rights over pre-existing acquisition security rights in future inventory)

54. There was general support in the Working Group for the substance of the recommendation that the acquisition security right should have priority over a pre-registered (rather than pre-existing) non-acquisition security right in future inventory if the acquisition financier retained actual possession of the inventory or, before delivery of the actual possession of the inventory to the buyer, grantor or financial lessee acting in that capacity, registered a notice and notified pre-registered inventory financiers. In response to a number of questions, it was stated

that the notification did not need to describe the assets in specific terms or mention that it related to an acquisition security right; the notification was a condition to the right of the acquisition financier being given super-priority; and failure to notify a pre-registered inventory financier would result in that financier's right having priority over the acquisition financier's right.

55. The view was expressed that the acquisition financier should be allowed to register within a grace period after delivery of the inventory to the buyer, grantor or financial lessee. It was stated that, without such a grace period, the acquisition financier would not finance the acquisition of inventory by the buyer, grantor or financial lessee. It was also observed that, in the absence of a grace period, the acquisition financier would have to delay the delivery of the inventory until it had the opportunity to register and notify pre-registered inventory financiers, which could take several days. The prevailing view, however, was that a grace period would inadvertently result in inventory financiers withholding credit until the expiry of the grace period, since inventory was fungible and turned over so quickly that inventory financiers would be unable to monitor its movement. It was observed that the acquisition financier would not be prevented from extending credit because of the lack of a grace period since it could obtain super-priority by first registering and notifying pre-registered inventory financiers, and then delivering the goods to the buyer, grantor of financial lessee. It was also stated that, unlike equipment, it was not easy to distinguish old from new inventory and to determine the time of delivery since the inventory financier could not monitor constantly moving assets, such as inventory. In response to a question, it was noted that recommendation 3, which allowed a grace period for the registration of acquisition security rights in both inventory and equipment, provided a super-priority to the acquisition financier only over creditors that obtained a security right within the grace period. It was also noted that, while the question whether notification was effective at the time it was sent or received was a matter of other law, it should be addressed by the legislator.

56. After discussion, the Working Group decided that no grace period should be allowed for the registration of acquisition security rights in inventory.

Recommendation 7 (cross-collateralization)

57. There was general support in the Working Group for the recommendation that the acquisition financier should not lose its super-priority just because it had a non-acquisition security right in other assets of the buyer, grantor or financial lessee securing the same obligation as that secured by the acquisition security right or had a non-acquisition security right in the same assets securing, however, other (non-acquisition) obligations of the buyer, grantor or financial lessee.

Recommendation 8 (priority of acquisition security rights in proceeds of inventory)

58. With respect to recommendation 8, differing views were expressed. One view was that recommendation 8 should be retained in its current formulation, providing that the super-priority right of an acquisition financier should not extend to proceeds of inventory (e.g. receivables). It was stated that such an approach would allow the buyer, grantor or financial lessee to obtain other kinds of financing, such as receivables financing, with which it could pay off the inventory debt or other working expenses. Another view was that the super-priority of acquisition security

rights in inventory should be extended to proceeds of inventory (in all cases or only if agreed between the acquisition financier and the buyer, grantor or financial lessee). However, the prevailing view was that the super-priority of an acquisition security right should extend to proceeds of the acquired inventory, provided that the acquisition financier notified financiers that had previously registered a security right in assets of the same kind as the proceeds. It was stated that such an approach was consistent with the approach taken with respect to super-priority in inventory, would avoid double financing and would protect pre-registered financiers to the extent that the super-priority would relate to identifiable proceeds. While some doubt was expressed with regard to those advantages of that approach, after discussion, the Working Group decided that recommendation 8 should be recast to provide super-priority to acquisition security rights in proceeds of inventory, provided that the acquisition financier would notify pre-registered financiers with a security right in assets of the same kind as the proceeds.

Recommendations 9 and 10 (enforcement)

59. The Working Group agreed with the substance of recommendation 9 that, upon default by the grantor, the acquisition financier would be entitled to repossess and dispose of the goods subject to the rules applicable to the enforcement of non-acquisition security rights generally. It was stated that such a rule would be appropriate for a State that adopted an integrated approach. However, it was also observed that the remedies available to an acquisition financier should be discussed in the commentary with appropriate cross-references to the chapter on default and enforcement, since even in the context of an integrated approach, non-acquisition financiers could be given special rights as long they were all treated equally.

60. As to recommendation 10, differing views were expressed. One view was that it appropriately reflected an approach taken in States that treated acquisition financing devices as title devices. It was stated, however, that not all such systems took the approach recommended in recommendation 10. Another view was that, in order to better reflect the non-integrated approach, recommendation 10 or the commentary needed to discuss in more detail how acquisition financing devices would be enforced compared to non-acquisition financing devices. Such an approach would require, for example, that the recommendation or the commentary specify the remedies available to acquisition financiers (e.g. how would an acquisition financier repossess the goods and what rights would accrue to that financier after repossession), providing guidance as to the impact of secured transactions law on sales and property law. It was stated that equivalence of rights of acquisition financiers with the rights of non-acquisition financiers was a key policy objective that could not be achieved if, for example, a deficiency claim was not recognized for the acquisition financier or if the financier was given the right to retain any surplus. It was also observed that, in the absence of a deficiency claim, a financier would have an incentive to request more encumbered assets, limiting the grantor's possibility to use its assets so as to obtain credit from other creditors, which would be inconsistent with the overall objective of the guide to increase the availability of secured credit. In addition, it was said that there was no economic or other justification in providing the acquisition financier with a right to retain a surplus, a result that would amount to unjust enrichment. Moreover, it was pointed out that another way to achieve equivalence between acquisition financiers and non-acquisition financiers was to refer to the principles reflected in the chapter on

default and enforcement, such as the principle that the acquisition financier should enforce its rights in good faith and in a commercially reasonable manner.

61. After discussion, it was agreed that recommendation 10 should be recast to address the substance of a non-integrated approach, treating all acquisition financiers equally and in a manner that would be equivalent with the manner non-acquisition financiers would be treated.

Recommendations 11 and 12 (insolvency)

62. There was sufficient support in the Working Group for recommendation 11. It was stated that, by suggesting that acquisition security rights should be treated in the same way as non-acquisition security rights, recommendation 11 reflected what was called in earlier discussions the integrated approach (i.e. the same set of rules would apply to both acquisition and non-acquisition security rights and any special rules would apply to all acquisition security rights equally).

63. Some support was expressed for recommendation 12. It was stated that it appropriately reflected the approach taken in many legal systems that treated acquisition financing devices as title devices. However, it was suggested that recommendation 12 should be recast to address the rights of the acquisition financier in the case of insolvency rather than the duties of the insolvency representative.

64. At the same time, a number of concerns were expressed with respect to recommendation 12. One concern was that recommendation 12 did not sufficiently reflect the only other alternative approach approved by the Working Group (the non-integrated approach), which involved the application to acquisition security rights of a set of rules that was different from, but equivalent to, the set of rules applicable to non-acquisition security rights. Another concern was that, by suggesting what an insolvency representative could or could not do, recommendation 12 inappropriately interfered with insolvency law.

65. Yet another concern was that, to the extent that recommendation 12 might be read as suggesting that the insolvency representative was obliged to decide quickly to perform or reject the contract, it might be inconsistent with the UNCITRAL Legislative Guide on Insolvency Law ("the UNCITRAL Insolvency Guide"), which allowed the insolvency representative sufficient time to determine, inter alia, whether the business should be liquidated or reorganized, and whether one or the other contract should be performed or rejected. In addition, it was stated that recommendation 12 might not be fully in line, for example, with recommendation 54 of the UNCITRAL Insolvency Guide, which provided that the insolvency representative might use assets owned by a third party and in the possession of the grantor, provided that certain conditions were satisfied (e.g. the interests of the third party would be protected against diminution in the value of the asset and the costs under the contract of continued performance of the contract and use of the asset would be paid as an administrative expense).

66. In that connection, it was stated that a treatment of acquisition security rights that would be consistent with the treatment of third-party owned assets in the UNCITRAL Insolvency Guide could form part of the non-integrated approach. It was observed that, in the context of such an approach, it was crucial that nominal differences would not be allowed to lead to different outcomes and that, in order to

increase the availability of credit, all acquisition security rights would be treated equally, even if somehow differently from non-acquisition security rights. It was also said that the recommendations as to the treatment of acquisition security rights in insolvency should balance the overall objective of the guide to increase the availability of secured credit with the objectives of the UNCITRAL Insolvency Guide to maximize the value of the estate for the benefit of all creditors and to facilitate reorganization.

67. After discussion, it was agreed that all acquisition financing devices should be treated equally, whether a State integrated them in its secured transactions law or to a different but equivalent set of rules. In addition, it was agreed that on the treatment of acquisition devices to the guide should be consistent with the UNCITRAL Insolvency Guide. Moreover, it was agreed that the question that the guide should address was which recommendations of the UNCITRAL Insolvency Guide should apply to acquisition financing devices, those dealing with security rights or those dealing with third-party owned assets. The Secretariat was requested to prepare a revised version of recommendations 11 and 12 that would reflect the understanding of the Working Group.

Recommendations 13 and 14 (conflict of laws)

68. In response to a question, it was noted that if a State took an integrated approach, recommendations 13 and 14 would not be required as they repeated the recommendations applicable to non-acquisition security rights. While it was noted that these recommendations would be necessary if a State took a non-integrated approach, it was agreed that that result could be achieved by a reference to the rules applicable to non-acquisition security rights (with the exception of recommendation 102, which dealt with the law applicable to security rights in intangible property).

Recommendation 15 (transition)

69. It was stated that acquisition financiers should be given a short period of time after the effective date of the new law, within which they could register their rights in the secured transactions registry and preserve their priority. However, it was observed that there should not be a longer transition period for acquisition security rights, as such an approach would inadvertently result in delaying possibly for years the application of the new law. The Working Group agreed that transition issues should be discussed in the chapter on transition.

Chapter XVI. Security rights in bank accounts (A/CN.9/WG.VI/WP.18 and Add.1)

A. General remarks

70. Broad support was expressed for including bank accounts within the scope of the guide. It was stated that a modern regime on secured transactions could simply not ignore bank accounts. It was also observed that lack of an appropriate legal regime on security rights in bank accounts was an obstacle to business parties using one of their most important assets to obtain credit. There was also support for the

suggestions that: the discussion on bank accounts should be integrated in the relevant chapters of the guide (on scope, creation, third-party effectiveness, priority and so on); and the general recommendations should apply, unless special rules were necessary, the reasons for which needed to be carefully considered.

B. Recommendations

71. The Working Group proceeded to discuss the recommendations with respect to security rights in bank accounts.

Paragraph 81 (scope of bank account)

72. It was suggested that the recommendation and the commentary should clarify that internal bank accounts were not covered.

Paragraph 82 (coordination with securities law)

73. There was broad support for the idea that bank accounts should be clearly distinguished from securities accounts. While there was support that the legal regime on bank accounts should be identical or at least coordinated with the legal regime on securities, it was agreed that the relevant wording in paragraph 82 should be retained in square brackets until the Working Group had the opportunity to consider the substance of the rules recommended. It was also agreed that the reference to specific legal texts in paragraph 82 should be deleted.

Paragraph 83 (creation)

74. There was broad support for the proposition that the general recommendations dealing with the creation of security rights should apply to the creation of a security right in a bank account. It was noted that regulatory and consumer-protection law would, in any case, not be affected.

75. The Working Group agreed with the substance of paragraph 83 and requested the Secretariat to revise the commentary to take into account the comments expressed and the suggestions made, in particular the need to explain: (i) the application of the general rules to bank accounts; (ii) any special rules with respect to anti-assignment agreements; and (iii) any exceptions introduced by consumer-protection laws.

Paragraph 84 (third-party effectiveness)

76. There was support in the Working Group for paragraph 84. The Working Group requested the Secretariat to further explain in the commentary the method of control as an alternative to registration, in particular when obtained by a transfer of the bank account to the secured creditor. It was also agreed that the depositary bank should be under no obligation to respond to queries by third parties as to the existence of a control agreement.

Paragraphs 85 and 86 (priority)

77. The Working Group agreed with the substance of paragraphs 85 and 86.

Paragraph 87 (enforcement)

78. The Working Group agreed with the substance of paragraph 87, providing for extra-judicial enforcement by the secured creditor in control of the bank account with limited and clearly prescribed exceptions (including insolvency). While it was agreed that the commentary explained the special character of a bank account and should be retained, it was also agreed that, to the extent a recommendation repeated the general rule, it might not be necessary.

Paragraph 88 (rights and duties of the depositary bank)

79. There was support in the Working Group for paragraph 88 that the depositary bank could not be bound to enter into a control agreement or assume any other duties against its consent. It was suggested that the recommendation should be incorporated in paragraph 83 dealing with the creation of a security right in a bank account.

Paragraph 89 (applicable law)

80. It was agreed that the recommendation should contain two alternatives, the law governing the account agreement and the law of the location of the depositary bank which had the closest connection to the bank account. It was also agreed that reference should be retained within square brackets to the grantor's location for third-party effectiveness obtained by notice filing, if notice filing was not recognized by the otherwise applicable law.

V. Future work

81. The Working Group noted that its eighth session was scheduled to take place in Vienna from 5 to 9 September 2005 and that its ninth session was scheduled to take place in New York from 30 January to 3 February 2006, those dates being subject to approval by the Commission at its thirty-eighth session scheduled to take place in Vienna from 4 to 15 July 2005.

Notes

[1] *Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 358. For a history of the project, see A/CN.9/WG.VI/WP.15, paras. 6-17. The reports of the first to the sixth sessions of the Working Group are contained in documents A/CN.9/512, A/CN.9/531, A/CN.9/532, A/CN.9/543, A/CN.9/549 and A/CN.9/570. The reports of the first and the second joint sessions of Working Group V (Insolvency Law) and VI (Security Interests) are contained in documents A/CN.9/535 and A/CN.9/550. The consideration of those reports by the Commission is reflected in documents A/57/17 (paras. 202-204), A/58/17 (paras. 217-222) and A/59/17 (paras. 75-78).

[2] Ibid., *Fifty-fifth Session, Supplement No. 17* (A/55/17), para. 455, and *Fifty-sixth Session, Supplement No. 17* and corrigendum (A/56/17 and Corr.3), para. 347.