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Report of Working Group VI (Security Interests) on the work of its eleventh session

(Vienna, 4-8 December 2006)

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I. Introduction

1. At its eleventh session, Working Group VI (Security Interests) continued its work on the preparation of a legislative guide on secured transactions pursuant to a decision taken by the Commission on International Trade Law (UNCITRAL) 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 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 eleventh session in Vienna from 4 to 8 December 2006. The session was attended by representatives of the following States members of the Working Group: Algeria, Argentina, Australia, Austria, Belgium, Canada, China, Colombia, Czech Republic, France, Germany, Guatemala, India, Iran (Islamic Republic of), Italy, Japan, Jordan, Mexico, Nigeria, Pakistan, Paraguay, Poland, Qatar, Republic of Korea, Russian Federation, Spain, Sweden, Switzerland, Thailand, Tunisia, Turkey, Uganda, United Kingdom of Great Britain and Northern Ireland and United States of America.

3. The session was attended by observers from the following States: Congo, Dominican Republic, Indonesia, Ireland, Kuwait, Latvia, Libyan Arab Jamahiriya, Malaysia, Mauritius, Peru, Philippines, Romania and Slovakia.

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

(a) *United Nations system*: International Monetary Fund and World Bank;

(b) *International non-governmental organizations invited by the Commission*: American Bar Association, Center for International Legal Studies, Commercial Finance Association, Forum for International Commercial Arbitration, International Association of Restructuring, Insolvency and Bankruptcy Professionals (INSOL International), International Chamber of Commerce, International Swaps and Derivatives Association, Max Planck Institute for Foreign and Private International Law, Moot Alumni Association, European Law Students' Association and Union internationale des avocats.

5. The Working Group elected the following officers:

Chairman: Kathryn SABO (Canada)

Rapporteur: Maria Mercedes BUONGERMINI (Paraguay)

6. The Working Group had before it document A/CN.9/WG.VI/WP.29, containing revised recommendations for inclusion in the draft guide.

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 a legislative guide on secured transactions.

5. Other business.

6. Adoption of the report.

III. Deliberations and decisions

8. The Working Group considered recommendations in chapters I (Key objectives of an effective and efficient secured transactions law), II (Scope of application), VI (The registry system), VII (Priority of a security right as against the rights of competing claimants), X (Default and enforcement), XI (Insolvency) and XII (Acquisition financing devices). The deliberations and decisions of the Working Group are set forth below in chapter IV of the present report. The Secretariat was requested to revise the recommendations in the above chapters of the draft guide to reflect the deliberations and decisions of the Working Group.

IV. Preparation of a legislative guide on secured transactions

Chapter I. Key objectives of an effective and efficient secured transactions law

Purpose

9. The Working Group approved the substance of the purpose section unchanged.

Recommendation 1 (key objectives)

10. Subject to clarifying the importance of predictability and transparency of security rights by registration as a separate key objective of the draft guide, the Working Group approved the substance of recommendation 1.

Chapter II. Scope of application

Purpose

11. The Working Group approved the substance of the purpose section unchanged.

Recommendation 2 (assets, parties, secured obligations and security rights)

12. With respect to recommendation 2, paragraph (e), it was agreed that the commentary should explain that regional or international obligations of a State might require that exceptions to the recommendation be made. In particular, it was noted that States members of the European Union might need to exclude transfer of title in financial collateral, such as securities, cash and funds in bank accounts, as under Directive 2002/47/EC of the European Parliament and of the Council of the European Union of 6 June 2002 on financial collateral arrangements, transfer of title had to be recognized according to its terms.

Recommendation 4 (aircraft, railway rolling stock, space objects, ships and intellectual property)

13. With regard to recommendation 4, paragraph (a), it was agreed that it should be revised to reflect the understanding reached with respect to the relationship between the United Nations Convention on the Assignment of Receivables in International Trade (the "United Nations Assignment Convention") and the Convention on International Interests in Mobile Equipment (Cape Town, 2001). As to recommendation 4, paragraph (b), it was agreed that reference should be made to special laws in general rather than to existing laws only.

Recommendation 5 (securities and immovable property)

14. With respect to recommendation 5, it was agreed that it should be divided into two parts, one dealing with securities and another dealing with immovable property.

15. With respect to securities, the Working Group agreed that the draft guide should cover directly held securities to ensure that the draft guide applied to important financial transactions, such as transactions in which a parent company obtained credit by offering a security right in the shares of its wholly owned subsidiaries. It was also agreed that the exclusion in recommendation 5 should apply to indirectly held securities.

16. As to whether the draft guide should apply to proceeds of directly and indirectly held securities, it was agreed that no additional wording was necessary. It was widely felt that proceeds of directly held securities would be covered in any case, while proceeds of indirectly held securities would be covered only to the extent they were not covered in another international instrument.

17. With respect to immovable property, it was agreed that it should be excluded from the scope of the draft guide, as the law in that regard was well settled and did not lend itself to unification. As to proceeds of immovable property, with respect to whose characterization as immovable or movable property legal systems differed, it was agreed that, if the proceeds took the form of receivables, they could be covered subject to the inclusion of language along the lines of article 4, paragraph 5 (a), of the United Nations Assignment Convention. It was noted that that text was aimed at ensuring that the creation and the priority of a security right under the law governing immovable property would not be affected. As to proceeds of immovable property other than receivables, it was agreed that they could be covered in the draft guide, if a security right in such proceeds was created by application of the law governing the immovable property or by agreement of the parties.

18. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 2 to 7.

Chapter V. Effectiveness of a security right against third parties

Purpose

19. The Working Group approved the substance of the purpose section unchanged.

Recommendation 39 (lapse in advance registration or third-party effectiveness of a security right)

20. While it was stated that the second sentence of recommendation 39 might be superfluous as it reiterated a priority rule reflected in recommendation 78, it was agreed that recommendation 39 was important and should be retained. However, to clarify the meaning of recommendation 39, it was also agreed that it should be separated into two sections, one referring to third-party effectiveness including registration after creation of a security right and another referring to advance registration (i.e. before creation of a security right).

Recommendation 40 (third-party effectiveness of a security right in tangibles by possession)

21. It was widely felt that, although "possession" was a defined term, recommendation 40 would be easier to understand if it referred to "the transfer of possession to the secured creditor" rather than to third-party effectiveness "through possession".

22. It was suggested that, to avoid creating the impression that transfer of possession was a condition for the creation of a security right rather than a formal requirement aimed at facilitating the proof of the security agreement (see recommendation 13), either recommendation 34 should refer to transfer of possession as well, or wording along the lines of the language of recommendation 34 should be included in recommendation 40. There was agreement that the proposed text should be included in the commentary. It was widely felt that the statement contained in recommendation 34, which was aimed at clarifying that registration under the regime envisaged in the draft guide was different from other types of registration known to most legal systems (such as registration in immovable property registries), was extremely important and should not be diluted by an additional reference to possession. It was also generally felt that recommendation 13 was sufficient in reflecting the understanding that possession was an element of proof rather than a condition for the creation of a security right.

Recommendation 41 (third-party effectiveness of a non-acquisition security right in low-value consumer goods)

23. Noting that, at the thirty-ninth session of the Commission, broad support had been expressed for the deletion of recommendation 41,[3] the Working Group agreed that recommendation 41 should be deleted. It was widely felt that recommendation 41 was not necessary, since there were no financing practices involving non-acquisition security rights in low-value consumer goods and referring to value would create uncertainty as third parties would have to find out the value of the consumer goods to determine whether a notice about a security right in such goods should be registered. The Working Group also agreed that recommendation 35, paragraph (b), which merely referred to recommendation 41, was superfluous and should be deleted as well.

Recommendations 43 and 44 (third-party effectiveness of a security right in proceeds)

24. The view was expressed that alternative A should be retained. It was stated that ensuring that a security right in proceeds became automatically effective against third parties when the proceeds arose without any further act being necessary would promote the overall goal of the draft guide to promote low-cost secured credit. It was also observed that, in any case, well-advised secured creditors would include a generic or specific reference to proceeds in their notices. So, it was pointed out that the main objective of alternative A was to avoid creating a trap for unwary secured creditors.

25. However, the prevailing view was that only alternative B should be retained. It was stated that both alternative A and alternative B were relevant only if the original encumbered assets were described in the notice by reference to a specific category of assets or to a specific asset, as a generic description of the original encumbered assets (e.g. "all assets") would cover all proceeds of any type. It was also observed that, under alternative B, if proceeds were in the form of money and similar assets, the notice would not need to be amended when the proceeds arose. In addition, it was pointed out that the notice would need to be amended only if proceeds took other forms (e.g. of a specific category of assets or a specific asset). Moreover, it was said that, if the grantor wanted to grant a security right in a specific category of assets or in a specific asset, the notice would need to be revised accordingly after the proceeds arose to ensure that the security right would not extend to proceeds other than those described in the notice registered with respect to the original encumbered assets. It was also mentioned that, unlike grantors, which could even be individuals, secured creditors were businesses, which were typically well advised and did not need special protection in that regard.

26. In the discussion, the suggestion was made that alternative A should be retained, while a priority rule could be devised along the lines of alternative B to protect buyers outside the ordinary course of business, as buyers in the ordinary course of business were sufficiently protected by recommendation 82 and subsequent financiers did not need to be protected as, in any case, they would do a search outside the registry to determine which assets were covered by the notice. That suggestion was objected to for the reasons mentioned above (see para. 25).

27. After discussion, the Working Group decided to delete alternative A and retain alternative B. It was also decided that alternative A should be discussed in the commentary along with the reasoning underlying alternative B. It was also agreed that the brief reference in recommendation 35, paragraph (d), to the rule in recommendations 43 and 44 should be aligned with the revised formulation of those recommendations.

Recommendation 45 (third-party effectiveness of a security right in a right that secures a receivable, negotiable instrument or any other obligation)

28. The concern was expressed that the title and the text of recommendation 45 failed to use neutral language in that it referred to a "security right in a security right", which was not appropriate in some legal systems, and to its third-party effectiveness. To address that concern, the suggestion was made that recommendation 45 should be revised or deleted. In support of deletion, it was

observed that recommendation 24 was sufficient to ensure, for example, that a right securing an assigned receivable would follow the receivable. However, the prevailing view was that recommendation 45 was useful and should be retained, but should be revised to track the language of recommendation 24 referring to the benefits of rights securing an assigned receivable.

Recommendation 54 (third-party effectiveness of a security right in a mass or product)

29. Differing views were expressed as to which alternative would be preferable in recommendation 54. In support of alternative A, it was stated that, unlike proceeds with respect to which the secured creditor retained a security right in the encumbered assets and acquired in addition a security right in another asset as proceeds, in the case of a mass of goods or product, the secured creditor did not acquire a broader right, as provided in recommendation 29. In support of alternative B, it was observed that, as in the case of proceeds, a different asset from the original encumbered asset was involved in situations where goods were commingled in a mass of goods or product (e.g. shoes or handbags were made of leather) and third parties needed to be informed about a security right in that new asset that would be effective against them. However, it was widely felt that there was a difference between proceeds and masses of goods or products, at least to the extent that the resulting product would mostly take the form of inventory and buyers of inventory in the ordinary course of business of the seller were already protected by recommendation 83. It was also generally considered that the objectives of the draft guide would better be served by a simple rule along the lines of alternative A. After discussion, the Working Group decided that alternative A should be retained and alternative B should be deleted.

30. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 30 to 54.

Chapter VI. The registry system

Recommendation 55 (operational framework of the registration and searching process)

31. With respect to recommendation 55, paragraph (c), it was agreed that the commentary could explain that the effectiveness of the registration was not dependent on who the registrant was but instead on the existence at the time of registration or thereafter of authority to register for which the creation of the security right should be sufficient.

32. With respect to recommendation 55, paragraph (j), it was agreed that it should be revised to provide that, in the case of an electronic registry, operation could be continuous with the exception of scheduled maintenance hours.

Recommendation 56 (security and integrity of the registry)

33. With respect to recommendation 56, paragraph (c), differing views were expressed. One view was that the obligation to send a copy of the notice should be placed on the registry. It was stated that the registry, as a third, neutral party, was

better placed to send the notice. It was also observed that any costs ensuing from that obligation would be covered by registration fees paid by registrants but ultimately borne by grantors. In addition, it was said that the registry could not be held liable for any error that was the result of inaccurate information on the notice.

34. The prevailing view, however, was that the secured creditor should be obliged to send a copy of the notice to the grantor. It was stated that the secured creditor was in a better place than the registry to send the notice to the grantor in a time- and cost-efficient way. In addition, it was observed that placing that obligation on the registry could potentially increase not only the operational cost of the registry but also the cost to cover any potential liability of the registry.

35. In the discussion, the question of the legal consequences of failure of the person obligated to send a copy of the notice to the grantor was raised. It was widely felt that such a failure could not affect the effectiveness of the security right or the registration and that any consequences should be limited to nominal penalties.

36. After discussion, it was agreed that the obligation to send a copy of the registered notice to the grantor should be placed on the secured creditor. As to the legal consequences of failure of the secured creditor to meet that obligation, it was agreed that the recommendation should include wording to limit such consequences to nominal penalties and any damages, resulting from the failure of the secured creditor to send the notice, that might be proven.

Recommendation 57 (responsibility for loss or damage)

37. The suggestion was made that responsibility for loss or damage caused by an error of the registry should be limited to malfeasance on the part of registry personnel rather than extend to system malfunction. There was no support for that suggestion.

Recommendation 58 (required content of notice)

38. The Working Group agreed that recommendation 58, paragraph (d), should be retained outside square brackets to permit a State to require that the notice include the maximum amount for which the security right could be enforced if it determined that that was useful for subordinate lending.

Recommendation 62 (change of the grantor's identifier)

39. Support was expressed in favour of all the alternatives in recommendation 62, dealing with a change in the identifier of the grantor. After discussion, the Working Group decided to retain alternative B giving the secured creditor sufficient time to discover a change in the identifier of the grantor and revise the notice on record. It was stated that the recommendation, as originally formulated, was based on a distinction between assets existing at the time of registration and assets acquired thereafter, which was irrelevant to the need to inform third parties about the change. It was also stated that alternative A might be unworkable as it required the grantor to notify the secured creditor, which would permit the grantor to render a security right ineffective against third parties.

40. At the end of the discussion of recommendation 62, the Secretariat was requested to prepare a new recommendation to address a change of the grantor

resulting from a sale of the encumbered assets, a merger, an acquisition or a similar transaction.

Recommendation 64 (time of registration)

41. It was agreed that the commentary could usefully explain that advance registration could take place before any element of creation (i.e. agreement, writing or acquisition of the assets by the grantor) was completed.

Recommendations 68 and 71 (cancellation or amendment of notice)

42. With respect to recommendation 68, it was agreed that the words "by full payment or otherwise" usefully clarified when a security right would be extinguished and should be retained outside square brackets.

43. With regard to recommendation 71, it was agreed that it should be retained outside square brackets to address the question of whether the notice needed to be amended when the secured creditor changed as a result of an assignment of the secured obligation. With respect to the alternatives in the recommendation, it was agreed that the language in the first set of square brackets should be retained to permit an amendment of the notice while, at the same time, ensuring the effectiveness of an unamended notice. It was also agreed that the commentary should explain that third parties relying on the notice should be protected.

44. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 55 to 71.

Chapter VII. Priority of a security right as against the rights of competing claimants

Recommendation 72 (extent of priority)

45. Recalling its decision with respect to recommendation 58, paragraph (d), (see para. 38 above) the Working Group agreed that the language in square brackets, referring to the maximum amount indicated in the notice, should be aligned with the text in recommendation 58, paragraph (d), and retained outside square brackets.

Recommendation 80 (priority of a security right in proceeds)

46. It was agreed that recommendation 80 should list all the exceptions to the rule that the security right in the proceeds had the same priority as the security right in the original encumbered assets.

Recommendations 82 and 83 (rights of buyers, lessees and licensees of encumbered assets)

47. With respect to recommendation 82, it was agreed that subparagraph (a) (ii) should be deleted since the grantor could not grant a security right in an asset that had already been sold to a third party. It was also agreed that subparagraph (b) (ii) could be retained as the grantor could grant a lease or a license in an encumbered asset.

48. With respect to recommendation 83, paragraph (a), it was agreed that buyers of consumer goods should take the goods free of any security right in the goods, as acquisition security rights in consumer goods were not subject to registration (see recommendation 185). It was also agreed that the language in the definition of "buyer in the ordinary course of business" (as well as the other definitions relevant to recommendation 83) should be added to the text of recommendation 83 for the sake of clarity, in particular as the definitions did not form part of the recommendations.

Recommendation 86 (priority of rights of judgement creditors)

49. With respect to the rule in the first sentence of recommendation 86, it was agreed that a security right should have priority over the right of a judgement creditor "unless" the judgement creditor obtained a judgement and took steps to enforce it before the security right was made effective against third parties. As an exception to that rule, it was also agreed that an acquisition security right should have priority over the right of a judgement creditor even if it was made effective after initiation of enforcement proceedings by the judgement creditor but within the grace period provided for in recommendation 184 (see also recommendation 188).

50. With respect to the rule in the second sentence of recommendation 86, differing views were expressed. One view was that that rule should be deleted or clarified to state that a security right should have priority over the right of a judgement creditor as long as credit was extended (i.e. actually paid) or committed (i.e. promised) before the judgement creditor notified the secured creditor. It was stated that the issuance of a judgement against the grantor of a security right at the initiative of an unsecured creditor did not always constitute an event of default permitting the secured creditor to terminate a lending commitment. As a result, a rule along those lines would discourage transactions based on lending commitments, such as a revolving credit facility. It was also observed that, even in cases where issuance of a judgement against the grantor of a security right constituted an event of default which entitled the secured creditor to terminate a lending commitment, the rule would still be inappropriate as it would result in termination of credit, a result that would be contrary to the overall objectives of the draft guide. In addition, it was said that, in some cases, termination of lending commitments was not possible (e.g. in the case of irrevocable letters of credit).

51. Another view was that the rule in the second sentence of recommendation 86 was appropriate and should be retained. It was stated that a security right would have priority if it were made effective against third parties before initiation of enforcement proceedings by an unsecured creditor. It was also observed that a security right would have priority even after initiation of enforcement proceedings up to the time when the judgement creditor notified the secured creditor. In addition, it was said that it was essential that after that time the judgement creditor would know whether there would be any value left in the grantor's assets for the judgement to be enforced. In order to achieve that result, it was said, it might suffice to set out and protect types of transaction that involved an irrevocable commitment to lend money.

52. After discussion, the Working Group agreed that the second sentence of recommendation 86 should be revised to reflect both views (see, however, para. 53 below).

53. At the end of its deliberations, the Working Group considered a proposal to ensure that a security right would have priority over the right of a judgement creditor not only with respect to advances but also with respect to irrevocable commitments made before the secured creditor was notified about the judgement. There was broad support for that suggestion. The Secretariat was requested to prepare appropriate wording to reflect that understanding.

Recommendation 87 (priority of rights of persons adding or preserving value of encumbered assets)

54. Differing views were expressed as to whether recommendation 87 should give priority to persons rendering services (e.g. repairers, storers or transporters) with respect to encumbered assets up to the value of the services, up to the value added or preserved as a result of the services rendered or up to the amount of reasonable expenses at the option of the parties. One view was that only claims up to the value added or preserved should be given priority over security rights. It was stated that subordinating a security right to claims of people that did not add to or preserve the value of encumbered assets might create uncertainty that could affect the availability or the cost of credit.

55. The prevailing view, however, was that priority should be given to the rights of persons rendering services with respect to encumbered assets up to the reasonable value of the services. It was stated that that was a limited rule that applied under law other than secured transactions law and only if the person rendering services was in possession of the encumbered assets. It was also observed that the intention of such a rule was to protect non-sophisticated persons that rendered services in the ordinary course of their business and did not have the bargaining power to obtain a security right. In addition, it was said that referring to value added or preserved might inadvertently give rise to a difficult and costly evidentiary burden for such non-sophisticated service providers.

56. After discussion, it was agreed that recommendation 87 should be revised to give priority to claims of service providers up to an amount covering a reasonable value of the services rendered.

Recommendation 92 (priority of a security right in a right to payment of funds credited to a bank account)

57. In response to a question, it was noted that no priority rule was mandatory as recommendation 75 provided that any competing claimant might at any time subordinate its priority unilaterally or by agreement in favour of any other existing or future competing claimant.

58. In response to another question as to whether the draft guide accommodated a system drawing a distinction between a “floating charge” (i.e. a security right in all assets of a grantor) and a “fixed charge” (i.e. a security right in specified assets), it was noted that the draft guide provided for a security right in all assets of a grantor where the grantor could retain possession of the encumbered assets and a licence to deal with them, but subsumed that right under the general notion of “security right” and did not subordinate it to a security right in specified assets. In that connection, it was stated that it would be for the legislator in each State enacting legislation based on the recommendations of the draft guide to review other bodies of existing domestic law and make any necessary adjustments.

59. In response to yet another question, it was noted that if, by claiming priority under the third sentence of recommendation 92 even over a person with whom the depositary bank had concluded a control agreement, the depositary bank committed a breach of contract, it might be liable to damages under law other than the secured transactions law.

60. After discussion, it was agreed that all those matters should be clarified in the commentary.

Recommendation 95 (priority of a security right in money)

61. It was agreed that the commentary should give examples of transactions in which a security right in money was granted and explain the meaning of the notion of "money" (i.e. notes and coins).

Recommendations 101 and 102 (priority of a security right in attachments to movable property subject to a specialized registration or title certificate system)

62. It was agreed that recommendation 101 could be deleted on the understanding that recommendation 79 would be revised to cover security rights in attachments as well.

63. It was also agreed that recommendation 102 could be retained to cover certain types of attachment to movable property, such as large aircraft engines or parts of motor vehicles, which were subject to separate registration in registries other than the registries in which security rights in the movable property were registrable.

Recommendations 103-105 (priority of a security right in a mass or product)

64. It was agreed that the reference to "the remainder of the aggregate value" in recommendation 104 could be usefully clarified.

65. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 72 to 105.

Chapter X. Default and enforcement

Recommendation 131 (liability)

66. It was agreed that the commentary could explain that recommendation 128 was sufficient to address a waiver or variation of liability of the secured creditor for failure to comply with its obligations under the provisions of the law on default and enforcement, which was the subject of recommendation 131.

Recommendation 136 (summary judicial proceedings)

67. It was agreed that recommendation 136 or the commentary could elaborate on the meaning of summary judicial proceedings by referring to: (a) the need of the process to be available promptly upon request; (b) notice and opportunity to all interested parties to be heard in accordance with minimum procedural safeguards available in the relevant jurisdiction; and (c) the cost of the proceedings.

Recommendation 140 (court relief)

68. It was widely felt that recommendation 140 could not include a uniform list of measures aimed at deterring unfounded applications to a court or improper interference with the enforcement process because procedures differed from State to State. However, it was agreed that one measure that might be recommended was to shift the burden of paying the costs of the proceedings on the losing party, which could be useful, at least, if the debtor was not insolvent or a solvent third-party guarantor was involved.

Recommendation 142 (secured creditor's right to take possession of an encumbered asset)

69. It was agreed that paragraph (a) of recommendation 142, which was common to both alternative A and alternative B, should be retained. It was widely felt that including in the security agreement a reference to the right of the secured creditor to take possession of the encumbered asset out of court put the grantor on notice at the outset.

70. It was also agreed that paragraph (c) of recommendation 142 should be retained to reflect the rule that out-of-court repossession of the encumbered assets by the secured creditor was permitted only in the absence of any objection by the grantor at that time. It was widely felt that objection would be evident in the case of use or threat of use of force, duress or similar illegal behaviour on the part of the secured creditor. It was also agreed that requiring positive consent could create uncertainty as to the meaning, the time and the scope of such consent.

71. As to paragraph (b) of recommendation 142, differing views were expressed. One view was that alternative A was preferable as it put the grantor on notice without giving the opportunity to a bad faith grantor to conceal the assets or otherwise wrongfully remain in possession of the assets or requiring the secured creditor to describe all the enforcement process at a time when that might not be possible, problems that alternative B was said to raise. Another view was that alternative B was preferable as, by requiring the secured creditor to give a notice of its intention to pursue extrajudicial enforcement with details, it gave the grantor a real opportunity to object, if the grantor so wished.

72. However, it was stated that paragraph (b) did not need to be so broad since: (a) recommendation 141 provided for the right of the secured creditor to take possession of the encumbered asset out of court in the event of default on the part of the grantor; (b) notice of default was sufficient to inform the grantor that it had defaulted; (c) the security agreement was sufficient to put the grantor on notice that the secured creditor had a right to take possession of the encumbered assets out of court; and (d) recommendations 145 and 148 were sufficient to deal with extrajudicial disposition of an encumbered asset and out-of-court acceptance of an encumbered asset by the secured creditor in total or partial satisfaction of the secured obligation. It was also observed that it was important to devise a rule that would encourage grantors to pay rather than use the judicial system to delay enforcement, which was a problem that was generally considered to have a negative impact on the availability and the cost of credit. In addition, it was said that the typical cases would involve business parties and commercial assets, such as inventory or equipment, rather than automobiles of consumers, with respect to which consumer-protection law would in any case prevail (see recommendation 2, paragraph (b)).

73. In the discussion, the suggestion was made that paragraph (b) of recommendation 142 could include a requirement that the secured creditor inform the grantor of the time it intended to take possession of the encumbered asset out of court. That suggestion was objected to. It was stated that reference to time could create questions, such as whether a notice that failed to mention the time would be effective, what would be the legal consequences of the secured creditor missing the time or what would happen if the grantor requested a change of time.

74. After discussion, it was agreed that paragraph (b) of recommendation 142 should be limited to extrajudicial repossession, focus on the notice of default and the right of the secured creditor to take possession of the encumbered asset out of court under recommendation 141, as well as on the consent of the grantor to out-of-court repossession by the secured creditor given in the security agreement.

Recommendations 144-146 (advance notice of extrajudicial disposition)

75. It was agreed that paragraph (d) of recommendation 145 should be deleted as: (a) recommendation 131 dealt with the liability of the secured creditor for failure to comply with its obligations under the law; (b) recommendation 140 entitled the grantor to obtain judicial relief if a secured creditor pursuing extrajudicial enforcement violated its obligations under the law; and (c) a new recommendation could be included to deal with the consequences of a failure of the secured creditor to comply with its obligations with regard to the rights acquired by a good-faith buyer, lessee or licensee.

76. It was also agreed that recommendation 146 was useful in that it stated the objectives of the notice and the manner in which it should be given and could thus be retained and placed before recommendation 145 or at its beginning.

Recommendations 157 and 158 (rights acquired through extrajudicial disposition)

77. It was agreed that a new recommendation could be included in the draft guide to address the consequences of failure of the secured creditor to comply with any of its obligations under the provisions of the law governing default and enforcement on the rights of a good-faith buyer, lessee or licensee of an encumbered asset.

78. With respect to recommendations 157 and 158, it was agreed that the reference to good faith could be deleted. It was widely felt that, in the case of an extrajudicial sale, lease or licence in compliance with the rules set forth in the law, the question of whether the buyer, lessee or licensee was in good faith would not arise. As to the remedies of the grantor in the case of an extrajudicial sale, lease or licence by the secured creditor not in compliance with the rules of the law to a person in bad faith, it was agreed that that matter could be addressed in recommendation 140.

79. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 126 to 170.

Chapter XI. Insolvency

80. It was noted that the recommendations on insolvency were the result of a significant amount of coordination between Working Group V and Working Group VI and had been approved in principle by the Commission at its thirty-ninth

session.[4] It was stated, however, that some drafting changes might still be needed in the additional insolvency recommendations of the draft guide on valuation of assets and post-commencement financing. It was also observed that some more recommendations from the *UNCITRAL Legislative Guide on Insolvency Law*[5] might need to be added (e.g. recommendation 63).

81. With respect to recommendation 172, support was expressed for both alternative A and alternative B. With respect to alternative B, it was suggested that some reference should be included to the principle of functional equivalence of secured transactions and retention-of-title devices. It was also suggested that, for reasons of clarity, a recommendation along the lines of alternative A should be added to reflect the unitary approach, which would otherwise be the understanding under the *UNCITRAL Insolvency Guide* (i.e. that references to security right in the *UNCITRAL Insolvency Guide* would apply to retention of title and functionally equivalent devices if a unitary approach were to be followed).

82. After discussion, the Working Group requested the Secretariat to prepare a recommendation along the lines of alternative A to reflect the unitary approach and referred the other suggestions made with respect to recommendation 172 to the Commission. In addition, recalling its decision (see para. 84 below) to refer in the non-unitary approach recommendation to retention of title only and have a separate text for functional equivalents of retention of title, the Working Group agreed that the same approach should be followed in recommendation 172.

Chapter XII. Acquisition financing devices

Terminology

83. The Working Group considered definitions (a) (“security right”) and (b) (“acquisition security right”), as well as the definitions suggested in the note to definition (b) (“acquisition financing devices”, “retention-of-title devices” and “ownership right under a retention-of-title device”).

84. It was noted that, pursuant to consultations between the secretariat of the International Institute for the Unification of Private Law (Unidroit) and the secretariat of the Commission, it was tentatively agreed that, to avoid overlap and conflict between the law recommended in the draft guide and a draft model law on leasing that Unidroit was preparing, that draft model law would defer with respect to leases that created a security right and to the definition of “security right” to the law recommended in the draft guide. However, to implement that approach, it was noted that the Working Group needed to devise a definition of “security right” that would cover both “acquisition security right” (which definition (a) already did) and “retention-of-title ownership (which definition (a) did not currently cover as it was not adjusted to the non-unitary approach developed in the draft guide). In addition, it was noted that financial leases needed to be defined so as to cover those that created a security right or the functional equivalent of a security right, but not other leases. After discussion, the Working Group requested the Secretariat to prepare the necessary definitions to ensure effective coordination between the law recommended in the draft guide and the draft model law on leasing being prepared by Unidroit.

85. It was agreed that the definition of “acquisition financing devices” could be retained. With respect to the definitions of “retention-of-title devices” and

"ownership under a retention-of-title device", it was suggested that they should refer only to retention of title, seller and buyer, as, although the same rules should apply to functional equivalents of retention-of-title devices, such as financial leases and purchase-money lending transactions, those latter transactions did not fall terminologically under the notion of "retention-of-title devices". That suggestion received support subject to ensuring that language would be added in the recommendations on the non-unitary approach to ensure that the recommendations on retention-of-title devices would apply to functionally equivalent transactions, such as financial leases and purchase-money lending transactions.

86. In that connection, it was suggested that the term "financial lease" needed to be defined to ensure that the law recommended in the draft guide would apply to a lease, at the end of the term of which the lessee would retain the asset subject to payment of a price, but not to a lease at the end of the term of which the lessee would return the asset to the lessor. There was support for that suggestion.

87. With respect to the definition of "ownership under a retention-of-title device", it was also agreed that it should be revised to reflect the conditional character of the sale and the resulting transfer ("until or under the condition that the price is paid").

88. Subject to the changes mentioned above, the Working Group approved the substance of the definitions of the terms "security right", "acquisition security right", "acquisition financing devices", "retention-of-title devices" and "ownership right under a retention-of-title device". The Working Group also agreed that text should be added to the recommendations on retention-of-title devices to ensure that they applied to functionally equivalent transactions, such as financial leases and purchase-money transactions. In addition, it was agreed that a definition of the term "financial lease" should also be included in the terminology.

A. Unitary approach to acquisition financing devices

Recommendation 183 (creation of an acquisition security right)

89. It was agreed that the rule applicable to the creation of a non-acquisition security right (i.e. recommendation 13) should also apply to the creation of an acquisition security right and, as a result, recommendation 183 (unitary approach) should be deleted.

Recommendation 185 (exceptions to the requirement of registration with respect to an acquisition security right)

90. It was agreed that the reference to "possession" in the second sentence of recommendation 185, which was intended to ensure that the exception from the registration rule in the first sentence for acquisition security rights in consumer goods did not affect methods of third-party effectiveness other than registration in the general security rights registry, could be deleted. It was widely felt that "possession" would be generally part of creation.

Recommendation 186 (priority of an acquisition security right in goods other than inventory or consumer goods as against an earlier registered non-acquisition security right in the same goods)

91. It was agreed that the priority given by recommendation 186 to an acquisition security right in goods other than inventory or consumer goods should also be given to an acquisition security right in consumer goods. It was widely felt that sales of

consumer goods to consumers should be protected. It was stated that the absence of registration would not adversely affect general, non-acquisition financing of consumer goods, as normally the general financier would not extend credit with future consumer goods as security.

Recommendation 192 (priority of an acquisition security right in proceeds of inventory)

92. It was widely felt that the super-priority given under recommendation 187 to acquisition security rights in inventory should not be extended to proceeds of inventory in the form of receivables. It was stated that such an approach would not discourage inventory acquisition financing as, in most jurisdictions, the rights of the inventory acquisition financier were extinguished after the sale of the inventory in the ordinary course of business. It was also observed that failure to exclude receivables from the rule in recommendation 192 would discourage receivables financing as the receivables financier would lose to the inventory financier. After discussion, it was agreed that the words "other than receivables" should be retained outside square brackets in recommendation 192.

B. Non-unitary approach to acquisition financing devices

Purpose

93. The Working Group postponed consideration of the text in square brackets in paragraph (b) of the purpose section until it had an opportunity to consider recommendation 193 where the issue of compatibility with the regime governing the enforcement of ownership rights arose (see para. 103 below). It was agreed that paragraph (c) of the purpose section should be aligned with paragraph (c) of the purpose section under the unitary approach.

Recommendation 182 (equivalence of an ownership right under a retention-of-title device to a security right)

94. The Working Group postponed consideration of the text in square brackets in recommendation 182 until it had an opportunity to consider recommendation 193 where the issue of compatibility with the regime governing the enforcement of ownership rights arose.

Recommendation 183 (creation of an ownership right under a retention-of-title device)

95. It was agreed that a minimal writing requirement should be adopted, permitting the use of electronic records and any evidence of the intention of the seller to retain title to the goods sold under retention of title. It was also agreed that an additional recommendation should be included to ensure that a buyer that bought goods under retention of title by the seller would be entitled, even before full payment and acquisition of ownership in the goods, to use the value paid for the goods to obtain credit secured by the goods. It was stated that that was possible even in jurisdictions in which retention-of-title devices were the main forms of non-possessory security under various theories, such as the theory that the buyer had an expectation of ownership.

96. In addition, it was stated that the reference to the creation of ownership rights should be revised as a retention-of-title sale did not actually "create" ownership. It

was also observed that a rule of interpretation could be added to ensure that a purchase-money security right could be created and have priority, while making clear that the purchase-money lender would not become the owner. After discussion, the Secretariat was requested to revise the formulation of recommendation 183, as well as any other recommendation that used the same formulation.

Recommendations 185 (exceptions to the requirement of registration with respect to an acquisition security right), 186 (priority of an acquisition security right in goods other than inventory or consumer goods as against an earlier registered non-acquisition security right in the same goods) and 192 (priority of an acquisition security right in proceeds of inventory)

97. It was agreed that the same changes made to recommendations 185, 186 and 192 in the context of the unitary approach should be made to those recommendations in the context of the non-unitary approach.

Recommendation 187 (priority of an ownership right under a retention-of-title device in inventory as against an earlier registered non-acquisition security right in inventory of the same kind)

98. Doubt was expressed as to whether priority was an appropriate concept to use with respect to ownership rights under retention-of-title devices (although it was admitted that priority was an appropriate concept for rights under financial leases and purchase-money lending transactions). However, it was clarified that that put into question neither the usefulness of recommendations 187 and 188 nor the need for registration of a notice about retention-of-title devices and their functional equivalents in the general security rights registry.

99. In that connection, serious concern was expressed as to the requirement to register ownership rights on the grounds that such an approach was contrary to current practice in many jurisdictions. In that connection, it was noted that, at its thirty-ninth session, the Commission had approved the substance of all the recommendations of the draft guide[6] and thus fundamental policy issues on which the Commission had reached a decision were no longer open for discussion by the Working Group. In any case, it was stated that the draft guide did not require registration of ownership rights but rather a notice informing third parties that the buyer in possession of the goods bought under retention of title might not be the owner. In addition, it was observed that the functional approach (requiring that the same or equivalent rules, including the rules on registration, applied to all devices serving security functions), had been approved both by the Working Group (see A/CN.9/574, para. 46 and A/CN.9/588, para. 52) and the Commission,[7] as it was essential for a secured transactions regime that would promote the availability of low-cost credit.

100. In the discussion, it was explained that, at least for some of those that expressed concern with regard to registration of retention-of-title rights, there was no fundamental objection to the notion of registration of retention-of-title rights as long as it was made clear that the draft guide did not require registration of ownership but rather of a notice aimed at informing third parties that the buyer might not be the owner of the goods in its possession.

Recommendation 193 (enforcement of an ownership right under a retention-of-title device)

101. It was agreed that both alternative A and alternative B should be retained. It was widely felt that, with respect to the enforcement of ownership rights under retention-of-title devices, the principle of functional equivalence should be followed but only to the extent that it was not incompatible with the regime applicable to the enforcement of ownership rights. It was stated that, to the extent that enforcement of ownership rights differed from State to State, application of the principle embodied in alternative B would result in non-uniform results. In addition, it was agreed that the commentary should explain the application of both alternative A and alternative B.

102. Recalling its decision to postpone consideration of the text in square brackets in paragraph (b) of the purpose section until it had had an opportunity to consider recommendation 193, the Working Group agreed that the bracketed text in paragraph (b) of the purpose section and recommendation 182 could be deleted. It was widely felt that the matter addressed in the bracketed text had been sufficiently dealt with in alternative B of recommendation 193 (non-unitary approach).

103. Also recalling its decision to refer in the non-unitary approach to retention of title, buyers and sellers only (see para. 85 above), the Working Group agreed that appropriate wording should be added to ensure that the non-unitary approach recommendations applied not only to retention of title but also to functionally equivalent devices, such as financial leases (properly defined to cover only those at the end of the term of which the assets would be transferred to the lessee) and other acquisition financing transactions.

104. Subject to the changes mentioned above, the Working Group approved the substance of recommendations 182 to 194 (unitary and non-unitary approach).

V. Future work

105. It was noted that the twelfth session of the Working Group was scheduled to take place in New York from 12 to 16 February 2007 and the fortieth session of the Commission was scheduled to take place in Vienna from 25 June to 12 July 2007. The Working Group also noted that the draft guide was expected to be considered by the Commission from 25 June to 2 July with final adoption expected to take place on 6 July 2007. In addition, the Working Group noted that from 9 to 12 July 2007 a congress on international trade law would take place in the context of the Commission session for delegates and experts to discuss relevant issues for future reference.

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.31. The reports of the first to the tenth 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, A/CN.9/570, A/CN.9/574, A/CN.9/588, A/CN.9/593 and A/CN.9/603. 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 the *Official Records of the General Assembly, Fifty-seventh Session, Supplement No. 17* (A/57/17), paras. 202-204, *Fifty-eighth Session, Supplement No. 17* (A/58/17), paras. 217-222, *Fifty-ninth Session, Supplement No. 17* (A/59/17), paras. 75-78, *Sixtieth Session, Supplement No. 17* (A/60/17), paras. 186-187, and *Sixty-first Session, Supplement No. 17* (A/61/17), paras. 13-78.

[2] *Official Records of the General Assembly*, *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.

[3] See *Official Records of the General Assembly, Sixty-first Session, Supplement No. 17* (A/61/17), para. 25.

[4] Ibid., para. 62.

[5] United Nations publication, Sales No. E.05.V.10.

[6] See *Official Records of the General Assembly, Sixty-first Session, Supplement No. 17* (A/61/17), paras. 13-78.

[7] Ibid., para. 18.