

UNCITRAL Model Law on Secured Transactions

Guide to Enactment



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UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

UNCITRAL Model Law on Secured Transactions

Guide to Enactment



UNITED NATIONS
Vienna, 2017

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Publishing production: English, Publishing and Library Section, United Nations Office at Vienna.

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Preface

At its forty-ninth session, in 2016, the Commission considered and adopted the UNCITRAL Model Law on Secured Transactions (the decision of the Commission and the relevant General Assembly resolution are contained in annex I).¹

At that session, having before it a first draft of a guide to enactment of the Model Law (the “Guide to Enactment”), the Commission noted that the Guide to Enactment would be an extremely important text for the implementation and interpretation of the Model Law, and gave Working Group VI (Security Interests) up to two sessions to complete its work and submit the Guide to Enactment to the Commission for final consideration and adoption at its fiftieth session, in 2017.²

At its thirtieth and thirty-first sessions in December 2016 and February 2017, Working Group VI discussed and approved the substance of the draft Guide to Enactment.

At its fiftieth session, in 2017, the Commission considered and adopted the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions (the decision of the Commission is contained in annex II).³

¹*Official Records of the General Assembly, Seventy-first Session, Supplement No. 17 (A/71/17)*, paras. 17-118.

²*Ibid.*, paras. 121 and 122. The draft Guide to Enactment before the Commission at its forty-ninth session is contained in documents A/CN.9/885 and Add. 1-4.

³*Official Records of the General Assembly, Seventy-second Session, Supplement No. 17 (A/72/17)*, para. 216. The draft Guide to Enactment before the Commission at its fiftieth session is contained in documents A/CN.9/914 and Add.1-6.

I. PURPOSE OF THE GUIDE TO ENACTMENT

1. The Guide to Enactment is intended to explain briefly the thrust of each provision of the UNCITRAL Model Law on Secured Transactions (the “Model Law”)⁴ and its relationship with the corresponding recommendation(s) of the UNCITRAL Legislative Guide on Secured Transactions (the “Secured Transactions Guide”)⁵ and other UNCITRAL texts on secured transactions,⁶ including the United Nations Convention on the Assignment of Receivables in International Trade (the “Assignment Convention”),⁷ the UNCITRAL Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (the “Intellectual Property Supplement”),⁸ and the UNCITRAL Guide on the Implementation of a Security Rights Registry (the “Registry Guide”).⁹

2. Together these texts provide comprehensive guidance to States with respect to legal and practical issues that need to be addressed in a modern secured transaction regime. To avoid unnecessary repetition, the Guide to Enactment incorporates by reference the relevant recommendations and commentary contained in the Secured Transactions Guide, the Intellectual Property Supplement and the Registry Guide.

3. A number of the provisions of the Model Law indicate that a State enacting the Model Law (the “enacting State”) is required to make a decision or choose among several options. The Guide to Enactment is also intended to explain the import of these decisions or choices and thus assist enacting States in making those decisions or choices.¹⁰

4. The Guide to Enactment is primarily directed to executive and legislative branches of Governments considering reform of their secured transactions laws. However, it may also provide useful insight to other users of the text, such as judges, arbitrators, practitioners and academics. It has been prepared by the Secretariat at

⁴ISBN: 978-92-1-133856-0

⁵United Nations publication, Sales No. E.09.V.12.

⁶*Official Records of the General Assembly, Seventieth Session, Supplement No. 17 (A/70/17)*, paras. 215 and 216.

⁷General Assembly resolution 56/81, annex (United Nations publication, Sales No. E.04.V.14).

⁸United Nations publication, Sales No. E.11.V.6.

⁹United Nations publication, Sales No. E.14.V.6.

¹⁰*Official Records of the General Assembly, Seventieth Session, Supplement No. 17 (A/70/17)*, para. 216.

the request of the Commission,¹¹ and is based on the deliberations and decisions of the Commission and Working Group VI.¹²

II. PURPOSE OF THE MODEL LAW

5. The purpose of the Model Law is to assist States in developing a modern secured transactions law dealing with security rights in movable assets. The Model Law is designed to increase the availability of credit at more affordable rates by providing an effective and efficient secured transactions law (see Secured Transactions Guide, rec. 1 (a)). The Model Law is based on the assumption that, to the extent that a secured creditor is entitled to rely on the value of the encumbered asset for the payment of the secured obligation, the risk of non-payment is reduced and this is likely to have a beneficial impact on the availability and the cost of credit. The Model Law is intended to be useful both to States that currently do not have efficient and effective secured transactions laws and to States that already have such laws but wish to modernize them, and harmonize them with the laws of other States that have modern secured transactions laws that are generally consistent with the Model Law (see Secured Transactions Guide, Introduction, para. 1). The Model Law has been designed for implementation in States with different legal traditions.

III. THE MODEL LAW AS A TOOL FOR MODERNIZING AND HARMONIZING LAWS

6. In general, States that incorporate the Model Law into their national law are advised to adhere as much as possible to its uniform text. This can help the enacting State to obtain the full economic benefit of the legal system envisioned by the Model Law, to avoid unintended consequences that may follow when a change in one provision has unforeseen effects elsewhere in the law, and to gain the benefits flowing from the harmonization of its secured transactions law with that of the laws of other States. This does not deprive enacting States of any necessary flexibility as the Model Law provides options and leaves a number of matters to the enacting State.

¹¹ *Official Records of the General Assembly, Seventy-first Session, Supplement No. 17 (A/71/17)*, paras. 17-118. United Nations Publication ISBN: 978-92-1-133856-0.

¹² The reports of the Working Group are contained in documents A/CN.9/899 and A/CN.9/904. During these sessions, the Working Group considered documents A/CN.9/WG.VI/WP.71/Add.1-6 and A/CN.9/WG.VI/WP.73. Earlier versions of the Guide to Enactment are contained in documents A/CN.9/WG.VI/WP.66 and Add.1-4 and A/CN.9/WG.VI/WP.69 and Add.1-2.

7. Examples of flexibility in the Model Law include the following: (a) certain terms used in the Model Law may need to be adjusted to ensure that they are meaningful in the context of local law (e.g. “authorized deposit-taking institution”, “movable property”, “immovable property” and “securities”; see art. 2, subparas. (c), (u) and (hh), and paras. 39, 53 and 65 below); (b) several provisions of the Model Law refer within square brackets to issues that are left to the enacting State (e.g. art. 1, para. 3 (e), and para. 28 below); (c) other provisions of the Model Law include options from which the enacting State may choose (e.g. art. 6, para. 3, and para. 88 below); (d) the Model Law leaves it to the enacting State to decide how to clarify in its enactment of the Model Law that the general rules are subject to the asset-specific rules (see footnote 4 of the Model Law); (e) the Model Law leaves it to the enacting State to decide whether to implement the Model Registry Provisions in its enactment of the Model Law, in a separate law or in another type of legal instrument (see footnote 8 of the Model Law); and (f) the Model Law leaves it to the enacting State to decide whether to incorporate the conflict-of-laws provisions of the Model Law in its enactment of the Model Law or in a separate law addressing conflict-of-laws issues generally (see footnote 36 of the Model Law).

8. The enacting State may need to make some changes to the Model Law in order to adapt it to its national legal system (for the harmonization of the enactment of the Model Law with other laws of the enacting State, see para. 9 below). Any modification, however, should not depart from the fundamental provisions of the Model Law, such as those implementing the functional, integrated and comprehensive approach to secured transactions (e.g. art. 1, para. 1, and art. 2, subpara. (kk), and paras. 23 and 68 below), the protection of the grantor and the debtor of the receivable (e.g. art. 1, paras. 5 and 6), the right of the parties to structure their security agreement as they wish to meet their needs (e.g. art. 3, and paras. 72-75 below), the notice registration system (e.g. art. 18, and para. 118 below), the priority between a security right and the right of a competing claimant (e.g. art. 29, and paras. 285-294 below) and the right to enforce a security right without application to a court or other authority while protecting the rights of the grantor and other parties with rights in the encumbered asset (e.g. art. 77, para. 3, and art. 78, para. 3, and paras. 443 and 447 below). Otherwise, the enacting State will not be able to obtain the full economic benefits to be derived from the Model Law or achieve the harmonization of its law with the law of other States that enact the Model Law.

9. In enacting the Model Law, States will also need to consider whether complementary amendments to other related laws (e.g. contract, property, insolvency, civil procedure and electronic commerce law) are required to ensure the overall coherence of its national law (see Secured Transactions Guide, Introduction, paras. 80-83). For example, it is extremely important that the insolvency law of the enacting State recognizes the effectiveness of a security right, its priority and its enforceability in the case of the grantor’s insolvency (for the treatment of security rights in

insolvency, see Secured Transactions Guide, chap. XII). In addition, enacting States will need to consider: (a) harmonization with their existing legal framework, concepts and drafting technique (see Secured Transactions Guide, Introduction, paras. 73-83); and (b) transition issues, including the preparation of an official commentary, model notice forms and agreements, the organization of educational programmes for users of the new law and the introduction of a case law reporting system if one is not already in place (see Secured Transactions Guide, Introduction, paras. 84-89).

10. Unlike an international convention, model laws do not require enacting States to notify the United Nations or other enacting States of their enactment. However, States are strongly encouraged to inform the UNCITRAL secretariat of their enactment of the Model Law (or indeed any other model law resulting from the work of UNCITRAL). This information will be made available on the UNCITRAL website to publicize the fact that the enacting State has adopted an international standard and will assist other States in their consideration of the Model Law.

IV. MAIN FEATURES OF THE MODEL LAW

A. RELATIONSHIP OF THE MODEL LAW WITH THE SECURED TRANSACTIONS TEXTS OF UNCITRAL

11. The Secured Transactions Guide, the Intellectual Property Supplement and the Registry Guide contain detailed commentary and recommendations on the issues that need to be addressed in a modern secured transactions law. However, they are lengthy texts and States will need assistance in transforming their recommendations into concrete legislative language. The Model Law responds to this need. By providing concrete legislative language, the Model Law also provides a higher level of uniformity than a guide does.

12. The Model Law reflects the policies embodied in the recommendations of the Secured Transactions Guide, the Intellectual Property Supplement and the Registry Guide. Differences in formulation between those recommendations and corresponding provisions of the Model Law are generally due to the legislative nature of the Model Law and are briefly explained in the relevant parts below.

13. For reasons explained, the Model Law also addresses, in a manner that is consistent with the goals and the policies of the Secured Transactions Guide and the other texts of UNCITRAL on secured transactions, matters that were not addressed in a recommendation, or even discussed in those texts (e.g. security rights in non-intermediated securities). Conversely, certain matters that were

addressed in the Secured Transactions Guide are excluded from the scope of the Model Law (e.g. security rights in the right to receive the proceeds under an independent undertaking) or are not addressed specifically (e.g. security rights in attachments to encumbered movable assets or immovable property).

14. The provisions of the Model Law on security rights in receivables are substantially based on the recommendations of the Secured Transactions Guide, which in turn are based on the Assignment Convention. A State that ratifies or accedes to the Convention, but does not yet have an efficient and modern secured transactions law, will need to enact the Model Law as well, because: (a) the Convention applies only to security rights in and outright transfers of receivables; (b) subject to limited exceptions, the Convention applies only to the assignment of international receivables and the international assignment of receivables (see art. 1, para. 1); (c) the Convention does not provide substantive rules on third-party effectiveness and priority but instead refers these matters to the applicable domestic law, that is, the law of the assignor's location (see art. 22); and (d) the Convention does not address and leaves other substantive law issues to the applicable domestic law (e.g. the form of the assignment).

15. Conversely, a State enacting the Model Law would be well advised to ratify or accede to the Assignment Convention as well, in order to promote effective international receivables financing, in particular as a convention provides a higher level of uniformity and transparency than a model law. States that are parties to a convention have the same law, except to the extent the convention allows reservations, while States enacting a model law have compatible but not exactly the same laws. This higher level of uniformity provided by the Assignment Convention has significant benefits. For example, if the States where the assignor, the assignee the debtors of the receivables are located ratify or accede to the Assignment Convention, lenders will be more willing to extend receivables financing to exporters and at more affordable cost, because they will understand the legal rules that apply to the receivables owed to the exporters and thus will be more confident that they will be able to collect them.

B. KEY OBJECTIVES, FUNDAMENTAL POLICIES AND IMPLEMENTATION OF THE MODEL LAW

16. As already mentioned (see para. 5 above), the key objectives of the Model Law are the same as those of the Secured Transactions Guide (see Secured Transactions Guide rec. 1 and Introduction, paras. 43-59). For example, the primary objective of the Model Law is to promote low-cost credit by enhancing the availability of secured credit (see Secured Transactions Guide rec. 1 (a) and Introduction, para. 49).

17. The fundamental policies of the Model Law are also the same as those of the Secured Transactions Guide (see Secured Transactions Guide, Introduction, paras. 60-72). One of these fundamental policies is a functional, integrated and comprehensive approach to secured transactions, under which any right created by agreement in any type of movable asset to secure the payment or other performance of an obligation is treated as a security right for the purposes of the application of the Model Law, regardless of the terms used by the parties to describe their agreement (e.g. pledge, charge, transfer of title for security purposes, retention-of-title sale or financial lease; see Secured Transactions Guide, Introduction, para. 62, chap. I, paras. 110-112, and chap. IX, paras. 60-84).

18. The enacting State may also wish to consider implementation issues, such as harmonization with existing law, issues of legislative method and drafting technique and issues relating to post-enactment acculturation (see Secured Transactions Guide, Introduction, paras. 73-89). For example, depending on its drafting method and technique, the enacting State may wish to consider: (a) including the key objectives of the Model Law in a preamble or other similar statement accompanying its enactment of the Model Law. That statement could be used in filling gaps in the Model Law (see Secured Transactions Guide Introduction, para. 80, and para. 80 below), and (b) producing an official commentary or guide to its enactment of the Model Law for use by courts and legal practitioners in interpreting and applying the law (see Secured Transactions Guide, Introduction, para. 86). Such an official commentary is likely to be particularly helpful if the Model Law introduces significant changes to the enacting State's previous secured transactions laws. Such a guide could explain the intent of the new law's provisions, in particular if they deviate significantly from the previous law, and, where necessary, provide concrete examples. Even more importantly, such an official commentary or guide could explain the fundamental principles that underlie the Model Law, such as the functional, integrated and comprehensive approach to secured transactions (see para. 17 above). As the Guide to Enactment discusses all these and other relevant issues (either directly or by reference to the Secured Transactions Guide), the enacting State's commentary or guide could draw on or refer to the Guide to Enactment and the Secured Transactions Guide to allow its courts to obtain interpretative guidance from the international source from which its law was derived.

V. ASSISTANCE FROM THE UNCITRAL SECRETARIAT

A. ASSISTANCE IN DRAFTING LEGISLATION

19. In the context of its technical assistance activities, the UNCITRAL secretariat is prepared to assist States with the preparation of legislation based on the Model Law. The same assistance is provided to Governments considering legislation based

on other UNCITRAL model laws (e.g. the UNCITRAL Model Law on Cross-Border Insolvency),¹³ or considering adhesion to one of conventions prepared by UNCITRAL (e.g. the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995)¹⁴ or the Assignment Convention).

20. Further information concerning the Model Law and other texts developed by UNCITRAL, may be obtained from the UNCITRAL secretariat at the address below:

International Trade Law Division, Office of Legal Affairs
United Nations
Vienna International Centre
P.O. Box 500
1400 Vienna, Austria

Telephone: (+43-1) 26060-4060 or 4061

Telecopy: (+43-1) 26060-5813

Electronic mail: uncitral@uncitral.org

Internet home page: www.uncitral.org

B. INFORMATION ON THE INTERPRETATION OF LEGISLATION BASED ON THE MODEL LAW

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

¹³ United Nations publication, Sales No. E.14.V.2.

¹⁴ United Nations publication, Sales No. E.97.V.12.

Article-by-article remarks

Chapter I. Scope of application and general provisions

Article 1. Scope of application

22. Article 1 draws on recommendations 1-7 of the Secured Transactions Guide (see chap. I, paras. 1-4, 13-15 and 101-112). It is intended to set out the various types of transaction and asset covered by the Model Law (see art. 1, paras. 1-4), as well as to clarify the relationship between the Model Law and other law (see art. 1, paras. 5 and 6). Generally, the Model Law follows the same functional, integrated and comprehensive approach to secured transactions as the Secured Transactions Guide. Thus, the Model Law applies to security rights, that is, to property rights in movable assets, created by an agreement to secure payment or other performance of an obligation, regardless of whether the parties have denominated them as security rights (see art. 1, para. 1, and the definition of the term “security right” in art. 2, subpara. (*kk*), and para. 68 below). However, there are some differences between the scope of the Model Law and the scope of the Secured Transactions Guide (see paras. 24, 26, 29 and 32-34 below).

23. In line with recommendation 3 of the Secured Transactions Guide and article 1, paragraph 1, of the Assignment Convention, article 1, paragraph 2, provides that the Model Law also applies to outright transfers of receivables by agreement that take place, for example, in the context of factoring transactions. The main reason for this approach is that the same third-party effectiveness and priority rules should apply to both outright transfers of and security rights in receivables because: (a) financing against receivables is often done using an outright transfer of the receivables rather than by the creation of a security right in the receivables; and (b) it is sometimes difficult to determine at the outset of a transaction whether it will be characterized as an outright transfer of, or the creation of a security right in, the receivables (see Secured Transactions Guide, chap. I, paras. 25-31). While most modern secured transactions laws generally follow this approach, some laws exclude certain types of outright transfers of receivables that do not have a financing function, such as: (a) outright transfers of receivables for collection purposes

where the transferee essentially acts only as a representative or trustee of the transferor; and (b) outright transfers of receivables as part of the sale of the business out of which they arose (unless the former owner remains in apparent control of the business), where the potential for other outright transferees, secured creditors or other third parties to be misled is limited.

24. Unlike the Secured Transactions Guide which covered security rights in the right to receive payment under an independent undertaking (see rec. 2 (a)), the Model Law excludes from its scope security rights in both the right to receive and the right to request payment under an independent guarantee or letter of credit, whether commercial or standby (see art. 1, para. 3 (a)). The reason for this exclusion is that implementation of the relevant recommendations of the Secured Transactions Guide would have made the Model Law unduly complex. Enacting States interested in dealing with security rights in those types of asset are encouraged to implement the relevant recommendations of the Secured Transactions Guide (reccs. 27, 50, 107, 127, 176 and 212).

25. To the extent that the provisions of the Model Law are inconsistent with the enacting State's law relating to intellectual property, article 1, paragraph 3 (b), of the Model Law defers to that law (see Secured Transactions Guide, rec. 4 (b)). This limitation is unnecessary if the enacting State has already coordinated the Model Law and its law relating to intellectual property or plans to do so in the context of the overall reform of its secured transactions law.

26. Unlike recommendation 4 (c) of the Secured Transactions Guide which excludes from its scope all types of securities, article 1, paragraph 3 (c), excludes only intermediated securities. The reasons for this approach are that: (a) non-intermediated securities often are part of commercial finance transactions (in which, for example, it is common for the lender to obtain a security right in shares in the borrower's wholly-owned subsidiaries or the shares of the borrower itself); (b) there are wide divergences among national regimes in this regard, which creates legal obstacles to their use across national borders; and (c) security rights in non-intermediated securities are not addressed in any other uniform law text and thus no guidance is otherwise provided to States with regard to such securities. Conversely, security rights in intermediated securities are excluded as the nature of such securities and their importance for the functioning of financial markets raise a broad range of issues that merit special legislative treatment and are addressed in other uniform law texts (see Secured Transactions Guide, chap. 1, paras. 37 and 38).¹⁵

¹⁵Such as the Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009; the "Unidroit Securities Convention") and the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary (The Hague, 2006; the "Hague Securities Convention").

27. Article 1, paragraph 3 (*d*), excludes payment rights under or from financial contracts governed by netting agreements, including foreign exchange transactions, because they raise complex issues that require special rules (see Secured Transactions Guide, chap. I, para. 39).

28. Combining the policy of recommendations 4 (*a*) and 7 of the Secured Transactions Guide, article 1, paragraph 3 (*e*), provides that the enacting State may exclude further types of asset (or transaction) to the extent that the matters that are addressed in the Model Law are governed by other law of the enacting State. The reason for this approach is to avoid inadvertently creating gaps (where that other law does not govern an issue addressed in the Model Law) or overlaps (where that other law governs an issue that is addressed in the Model Law as well). Assets that may be excluded from the scope of the Model Law in article 1, paragraph 3 (*e*) are, for example, assets that are subject to specialized secured transactions and registration regimes. Enacting States that have such regimes (e.g. ship, vehicle, aircraft or intellectual property registries) will have to consider a number of issues, including the following: (*a*) whether registration with respect to security rights in those types of asset should take place in the security rights registry, in the specialized registry or in both; (*b*) if registration may take place in both registries, coordination of the relevant registries (see Secured Transactions Guide, chap. IV, para. 117, and Registry Guide, paras. 66 and 70) and coordination of the relevant third-party effectiveness and priority rules (see Secured Transactions Guide, recs. 43 and 77, subpara. (*a*); see also Registry Guide, paras. 23, 30 and 65); (*c*) the priority of acquisition security rights in consumer goods that are effective automatically (see art. 24; and Secured Transactions Guide, chap. IX, paras. 125-128, and rec. 181); and (*d*) the determination of the law that is applicable to security rights in tangible assets subject to specialized registration (see Secured Transactions Guide, chap. X, paras. 37 and 38, as well as rec. 205).

29. Under article 10, paragraph 1, a security right in a type of asset covered by the Model Law extends to its identifiable proceeds. Under article 1, paragraph 4, the Model Law applies even if the proceeds are a type of asset that is outside the scope of the Model Law (e.g. intermediated securities), except to the extent that other law applies to security rights in assets of that type and governs the relevant matters.

30. With respect to the relationship with consumer-protection law, in line with the approach followed in the Assignment Convention (see art. 4, para. 4) and in the Secured Transactions Guide (see rec. 2 (*b*)), article 1, paragraph 5, is intended to preserve the application of consumer-protection law that protects a grantor or a debtor of an encumbered receivable (see also art. 1, para. 6, which preserves statutory limitations in general, and para. 31 below). For example, under consumer-protection law, it may not be possible to create or enforce a security right in all present and future assets, employment benefits, at least up to a certain amount, or

in necessary household items of a consumer, or to collect an encumbered receivable directly from a debtor that is a consumer. Enacting States that do not have a developed consumer-protection law may need to consider whether enactment of the Model Law should be accompanied by the enactment of such special protections for consumers.

31. Following the approach of recommendation 18 of the Secured Transactions Guide, article 1, paragraph 6 is intended to preserve limitations on the creation or the enforcement of a security right in, or the transferability of, certain types of asset (e.g. cultural objects) that are contained in other law. At the same time, it is intended to override any limitation that is based on the sole ground that an asset is a future asset, or a part of an asset or an undivided interest in an asset (see art. 8, subparas. (a) and (b), and para. 93 below). Paragraph 6 does not apply to contractual limitations on the creation or enforcement of a security right in, or the transferability of, receivables (see art. 13, and paras. 109-115 below) or rights to payment of funds credited to a bank account (see art. 15, and para. 119 below).

32. The Model Law does not include specific provisions on security rights in attachments to movable or immovable property (that is, tangible assets that are attached to movable or immovable property in a manner that does not cause them to lose their separate identity; see Secured Transactions Guide, Terminology).

33. With respect to attachments to movable property, there is no need for specific provisions because the general rules applicable to security rights in tangible assets are generally sufficient. Thus, a security right in a tangible asset that is or becomes an attachment to movable property may be created and made effective against third parties in accordance with the general rules of the Model Law without any further action (see recs. 21 and 41 of the Secured Transactions Guide). In addition, the general priority rules of the Model Law apply to the various priority competitions that might arise (see Secured Transactions Guide, chap. V, para. 115). Enacting States may, however, wish to enact a rule providing that a secured creditor enforcing a security right in an attachment to movable property is liable for any damage caused by the act of removal of the attachment other than any diminution in its value attributable solely to the absence of the attachment (see rec. 166 of the Secured Transactions Guide).

34. With respect to attachments to immovable property, the Model Law does not include special provisions because they involve issues of immovable property law that do not lend themselves to harmonization at the international level. Enacting States that wish to enact special provisions may wish to consider the relevant recommendations of the Secured Transactions Guide (see recs. 21, 41, 43, 87, 88, 164, 165 and 184).

Article 2. Definitions and rules of interpretation

35. Article 2 contains definitions and rules of interpretation with respect to most key terms used in the Model Law.¹⁶ Other terms are defined or explained in various articles of the Model Law. For example, the term “judgment creditor” is explained in article 37, paragraph 1 (see para. 317 below). Comments are made below only on those terms that are not self-explanatory or that are not sufficiently explained in the Secured Transactions Guide, on the terminology of which article 2 is based (see Secured Transactions Guide, Introduction, paras. 15-20).

36. The rules of interpretation of the Secured Transactions Guide also apply to the Model Law. For example: (a) the word “or” is not intended to be exclusive; (b) the singular includes the plural and vice versa; and (c) the words “include” or “including” are not intended to indicate an exhaustive list (see Secured Transactions Guide, Introduction, para. 17).

37. It should be noted that time periods set out in the Guide to Enactment are suggestions (not recommendations) for the enacting State to use for its consideration of what would be appropriate for its own circumstances. It should also be noted that issues relating to the measurement of time (e.g. whether only working days are meant) are left to other law of the enacting State. Depending on how those issues are addressed (e.g. whether official holidays are to be included), the enacting State may wish to consider adjusting the time periods suggested in the Guide to Enactment.

Acquisition security right

38. An acquisition security right may only be created in the following types of asset: (a) a tangible asset (other than a tangible asset that embodies an intangible asset, such as a negotiable instrument; see art. 2, subparas. (b) and (l), and para. 69 below); (b) intellectual property; and (c) the rights of a licensee under an intellectual property licence. To qualify as an acquisition security right, the security right must secure an obligation to pay the unpaid portion of the purchase price of the encumbered asset to the seller or to pay credit extended by another person to enable the grantor to acquire rights in the asset to the extent credit is actually used for that purpose. Where the security right secures additional obligations, it is an acquisition security right only to the extent it secures the credit extended to enable

¹⁶ Since the Model Registry Provisions may be enacted in a separate statute or other type of legal instrument, the term “registry” is defined both in article 2, subparagraph (ee), of the Model Law and article 1, subparagraph (k), of the Model Registry Provisions. If the Model Registry Provisions are enacted as part of the Model Law, the latter provision will not be necessary.

the grantor to acquire the asset and is a non-acquisition security right to the extent it secures the additional obligations. The distinction is important because of the special priority accorded to acquisition security rights where the specified conditions are satisfied (see arts. 37-42, and paras. 317-348 below).

Bank account

39. To underline the distinction between a “bank account” and a “securities account”, the Model Law defines: (a) the former term as “an account maintained by an authorized deposit-taking institution to which funds may be credited or debited” (see art. 2, subpara. (c)); (b) the latter term as “an account maintained by an intermediary to whom securities may be credited or debited” (see art. 2, subpara. (ii), and para. 66 below); and (c) the term “securities” in a manner that clearly excludes funds (see art. 2, subpara. (hh), and para. 65 below). The term “bank account” includes any type of bank account (e.g. current or checking and savings account). The term does not include a right against a bank to the payment of funds evidenced by a negotiable instrument drawn on that bank. The term “authorized deposit-taking institution” is intended to be sufficiently broad to include any institution authorized to receive deposits in any State.

Certificated non-intermediated securities

40. The term “represented” in the definition of the term “certificated non-intermediated securities” (see art. 2, subpara. (d)) is intended to be sufficiently broad to cover various equivalent terms that may be used in different jurisdictions (e.g. “covered” or “embodied”). The term “certificate” means only a tangible document that can be subject to physical possession. Thus, non-intermediated securities represented solely by an electronic record fall within the definition of uncertificated non-intermediated securities (see art. 2 subpara. (mm)).

Competing claimant

41. The term “competing claimant” is principally used in the context of a potential priority dispute between a security right and the rights of another person claiming rights in the encumbered asset (see art. 2, subpara. (e)). The term includes another creditor of the grantor that has a right in the asset (such as another secured creditor or a judgment creditor that has taken the steps necessary under other law of the enacting State to acquire a right in the asset), the grantor’s insolvency representative, and a buyer or other transferee, as well as a lessee or licensee of the asset.

Consumer goods

42. Unlike the definition of the term “consumer goods” in the Secured Transactions Guide, the definition of this term in the Model Law (see art. 2, subpara. (f)) includes the word “primarily” to clarify that the term: (a) includes goods primarily used or intended to be used by the grantor for personal, family or household purposes and only incidentally as equipment or inventory; and (b) excludes goods primarily used or intended to be used by the grantor as equipment or inventory and only incidentally as consumer goods. Accordingly, it is the primary use or the primary intended use of tangible assets by the grantor that determines whether they will be classified as consumer goods, equipment or inventory. It should be noted that the terms “consumer goods”, “equipment” and “inventory” are principally relevant to the articles on acquisition security rights (see paras. 46 and 50 below).

Control agreement

43. The term “control agreement” refers to an agreement in writing between the grantor, the secured creditor and the issuer (in the case of securities) or the deposit taking institution (in the case of rights to payment of funds credited to a bank account), according to which the issuer or the deposit-taking institution agrees to follow the instructions of the secured creditor without the further consent of the grantor (see art. 2, subpara. (g)). A control agreement can achieve two purposes: (a) to render a security right effective against third parties (see arts. 25 and 27, and paras. 136 and 140 below); and (b) to establish the priority of the secured creditor that has entered into the control agreement (see arts. 47 and 51, and paras. 352 and 362 below). In addition, a control agreement can help ensure the cooperation of the deposit-taking institution or the issuer of securities if the secured creditor needs to enforce its security right. Although the definition refers to an agreement in writing, it does not refer to a “signed writing” unlike the definition of this term in the Secured Transactions Guide. This difference does not reflect a policy change but rather a decision that the matter should be left to the authentication requirements for agreements of other law of the enacting State.

Default

44. In deference to party autonomy, the term “default” is defined to mean the debtor’s failure to pay or otherwise perform the secured obligation and any other event that constitutes default under the agreement between the grantor and the secured creditor (see art. 2, subpara. (j)). What exactly constitutes failure to pay or otherwise perform the secured obligation (e.g. a day’s or a month’s delay in payment) is a matter for the agreement between the parties and the law applicable to that agreement.

Encumbered asset

45. Any movable asset to which the Model Law applies is an encumbered asset once it is made the subject of a security right (see art. 2, subpara. (k)). As the provisions of the Model Law also apply to outright transfers of receivables by agreement, the term is defined to also include a receivable that is the subject of an outright transfer by agreement.

Equipment

46. Unlike the definition of the term “equipment” in the Secured Transactions Guide, the definition of that term in the Model Law includes the word “primarily” to clarify that it: (a) includes goods used or intended to be used by a person primarily as equipment and only incidentally as consumer goods or inventory; and (b) excludes goods used or intended to be used by a person primarily as consumer goods or inventory and only incidentally as equipment (see art. 2, subparas. (f), (l) and (q), as well as para. 42 above and para. 50 below). As the classification depends on the primary use or primary intended use of the asset, the same asset may, at different times, constitute equipment, consumer goods or inventory. For example, an automobile dealer may acquire a vehicle for personal use (consumer goods), then start using it in its business to provide a shuttle service for its customers (equipment) and then decide to offer it for sale as part of its stock of used vehicles (inventory). It is the use to which the asset is primarily put by the grantor at the time the security right is created that generally determines its classification for the purposes of the Model Law.

Grantor

47. The definition of the term “grantor” makes clear that a grantor of a security right may be the debtor of the secured obligation or another person (e.g. a parent company that creates a security right in its assets to secure the obligations of its subsidiary, or vice versa; see art. 2, subpara. (o) (i)). A buyer or other transferee of an encumbered asset that acquires the asset subject to a security right is also treated as a grantor to ensure that the provisions of the Model Law remain applicable even though the grantor has disposed of the encumbered asset (see art. 2, subpara. (o) (ii)). As the provisions of the Model Law also apply to outright transfers of receivables by agreement, the term “grantor” also includes a transferor under an outright transfer of receivables by agreement (see art. 2, subpara. (o) (iii)).

Insolvency representative

48. The term “insolvency representative” is used in the definition of the term “competing claimant” in article 2, subparagraph (e) (see para. 41 above), and the

term “insolvency proceedings” is referred to in articles 2, subparagraph (e) (iii), 35 and 94 (see para. 41 above, and paras. 312 and 500 below). In view of their limited relevance, these (and other insolvency-related terms, such as the term “insolvency estate”) are not defined in the Model Law. However, they are defined in the Secured Transactions Guide (see Introduction, para. 20) and the UNCITRAL Legislative Guide on Insolvency Law (the “Insolvency Guide”; see Introduction, para. 12). In particular, the term “insolvency representative” is defined in a sufficiently broad manner to include any person responsible for administering insolvency proceedings or supervising the debtor and the debtor’s affairs (see Insolvency Guide, part two, chap. III, paras. 11-18 and 35).

Intangible asset

49. The term “intangible asset” includes receivables, rights to the performance of obligations other than receivables, negotiable instruments or negotiable document in electronic form, rights to payment of funds credited to a bank account and uncertificated non-intermediated securities, as well as any other movable asset that is not a tangible asset (see art. 2, subpara. (p)). Whether an instrument or document is negotiable is a matter for other law.

Inventory

50. The term “inventory” refers to tangible assets held by the grantor for sale or lease in the ordinary course of the grantor’s business (art. 2, subpara. (q)). Thus, it is the purpose for which tangible assets are held by the grantor that determines whether they constitute inventory, consumer goods or equipment (see paras. 42 and 46 above). The term “work in process” includes “semi-processed materials”.

Mass and product

51. The Model Law distinguishes between a “mass” and a “product” (see art. 2, subpara. (s)). A “mass” arises when two or more tangible assets of the same kind are commingled in such a way that they lose their separate identity. For example, a quantity of oil from one source is pumped into a storage tanker that already contains oil from another source, or a quantity of wheat from one source is put into a grain silo that already contains wheat from another source. In contrast, a “product” is manufactured when a tangible asset is physically transformed so that it loses its separate identity, or when tangible assets are physically combined so that they lose their separate identities, through a production or manufacturing process; for example, gold is fashioned into a ring, or flour and yeast are combined

and baked to make bread. The distinction is relevant to articles 11 and 33 (see paras. 103-106 and 299-302 below).

Money

52. The term “money” is defined to mean currency authorized as legal tender by the enacting State or any other State (see art. 2, subpara. (t)). It does not include intangible money (e.g. virtual currency), as in the context of the Model Law the term “money” is intended to be physical notes and coins (see art. 2, subpara. (ll), and para. 69 below). Rights to payment of funds credited to a bank account and negotiable instruments are distinct concepts in the Model Law (see art. 2, subparas. (c) and (ll)). They too are not included in the term “money”.

Movable asset

53. The enacting State may wish to ensure that the definition of the term “movable asset” captures all assets that its law considers to be property other than immovable property (see art. 2, subpara. (u)). Depending on its legal tradition and terminology, the enacting State may also wish to consider replacing the terms “movable asset” and “immovable property” with the equivalent concepts in its law (e.g. “personal property” and “land”).

Non-intermediated securities

54. The term “non-intermediated securities” refers to securities other than securities credited to a securities account and rights in securities resulting from the credit of securities to a securities account (see art. 2, subpara. (w); for the definition of the term “securities, see art. 2, subpara. (hh), and para. 65 below; for the definition of the term “securities account”, see art. 2, subpara. (ii), and para. 66 below). The definition is adapted from the definition of the term “intermediated securities” in the Unidroit Securities Convention (see art. 1, subpara. (b)). It refers to “rights in securities”, in contrast to the Unidroit Securities Convention, which refers to “rights or interests in securities”. This approach is followed for reasons of consistency with the terminology of the Model Law in which the term “right” is a broad term that covers any right or interest. It should be noted that, if securities are held by an intermediary directly with the issuer (e.g. the intermediary is registered in the books of the issuer as the holder of the securities), these securities are not intermediated in the hands of that intermediary, even though equivalent securities credited by that intermediary to a securities account in the name of a customer are intermediated securities in the hands of the customer.

Notification of a security right in a receivable

55. The definition of the term “notification of a security right in a receivable” (see art. 2, subpara. (y)) is based on the definition of the term “notification of the assignment” in the Secured Transactions Guide (see Introduction, para. 20, and rec. 118), which in turn is based on the definition of that term in the Assignment Convention (see art. 5, subpara. (d)). The requirement for the notification to identify the encumbered receivable and the secured creditor in the definition of that term in the Assignment Convention is reflected in article 62, paragraph 1 (see para. 396 below), as it states a substantive rule on the effectiveness of a notification of a security right, a matter that is addressed in that article.

Possession

56. The definition of the term “possession” (see art. 2, subpara. (z)) is based on the definition of that term in the Secured Transactions Guide. The term “possession” applies only to tangible assets, and not to intangible assets, such as negotiable instruments and negotiable documents in electronic form (see art. 2, subpara. (p), and para. 49 above). Thus, the provisions of the Model Law that refer specifically to possession of tangible assets do not apply to negotiable instruments and negotiable documents in electronic form. The general provisions of the Model Law that apply to intangible assets apply to negotiable instruments and negotiable documents in electronic form, as they are movable assets in the sense of articles 1, paragraph 1 and 2, subparagraph (u) (see paras. 23 and 53 above). States that wish to enact both the Model Law and the UNCITRAL Model Law on Electronic Transferable Records should consider their relationship.

57. The words “directly or indirectly” in recommendation 28 of the Secured Transactions Guide were not included in this definition or article 16 which is based on that recommendation, because the definition of the term “possession” is sufficiently broad to cover situations in which a person is in possession of a tangible asset on behalf of another person.

Priority

58. The definition of the term “priority” (see art. 2, subpara. (aa)) is based on the definition of that term in the Secured Transactions Guide, which is in turn partly based on the definition of that term in the Assignment Convention (see art. 5, subpara. (g)). Like the definition in the Secured Transactions Guide, this definition does not include in the concept of “priority” the steps required to establish third-party effectiveness, as third-party effectiveness and priority are the subject

of separate rules in the Model Law. Like the definition in the Assignment Convention and unlike the definition in the Secured Transactions Guide, however, this definition defines the term “priority” to mean the right of a person in preference to the right of another person.

Proceeds

59. The term “proceeds” in the Model Law (see art. 2, subpara. (bb)) has the same meaning as in the Secured Transactions Guide. It covers: (a) proceeds of the sale or other disposition, lease or licence of an encumbered asset (broadly understood); (b) proceeds of proceeds (e.g. if receivables are generated by the sale of encumbered inventory and those proceeds are deposited to a bank account, the right to payment of those funds constitutes proceeds of proceeds); and (c) natural fruits (e.g. the calves of encumbered cows) or civil fruits (e.g. rental payments derived from the lease of encumbered assets). The terms “revenues”, “dividends” and “distributions”, which were included in the definition of this term in the Secured Transactions Guide, have been deleted on the understanding that they are covered by the term “civil fruits”. It should also be noted that the secured creditor’s right in proceeds is limited by various provisions of the Model Law. For example, under article 10, paragraph 1 (see para. 97 below), the security right extends only to identifiable proceeds (see also art. 19, para. 2, and para. 128 below).

60. The term is not limited to proceeds received by the original grantor but includes proceeds received by a transferee of an encumbered asset when that transferee is treated as a grantor because it acquired the encumbered asset subject to the security right. For example, where A creates a security right in its assets in favour of X and then transfers the assets to B who acquires its rights in the assets subject to X’s security right and B subsequently sells the assets to C for a price of €1,000 payable at a future date, the receivable arising from the sale by B to C constitutes proceeds covered by X’s security right. The reason for this approach is that, otherwise, a transferee of an encumbered asset that acquired the asset subject to the security right (in the example, B) could sell the asset further (in the example, to C) and retain the proceeds free of the security right. The problem this approach may pose for remote transferees who are likely to search the registry under the name of their immediate transferor and who will therefore not find a registered notice relating to a security right created by the grantor is addressed in art. 26 of the Model Registry Provisions.

61. It should be noted that proceeds may arise as a result of an action taken by a person other than the grantor or a transferee. For example, if funds in a bank account are transferred to another bank account at the instigation of the deposit-taking institution, the funds in the second bank account constitutes “proceeds”.

Receivable

62. The term “receivable” means a contractual or non-contractual right to payment of money (e.g. the right of a seller of an asset to payment of the purchase price, the right of a lender to payment of the loan or the right of a person who suffers harm due to the fault of another person to claim payment of damages from that person; see art. 2, subpara. *(dd)*). However, the term does not include a right to payment evidenced by a negotiable instrument, a right to payment of funds credited to a bank account or a right to payment under a non-intermediated security, as these rights are treated as distinct types of asset that are subject to different asset-specific rules of the Model Law.

Secured creditor

63. The term “secured creditor” refers to a person that has a security right (art. 2, subpara. *(ff)*). As the provisions of the Model Law also apply to outright transfers of receivables by agreement, the term also includes a transferee of a receivable in an outright transfer by agreement (e.g. a factor in a factoring contract).

Secured obligation

64. The term “secured obligation” includes any obligation secured by a security right, including obligations arising from credit extended by a lender, a retention-of-title seller or a financial lessor (see art. 2, subpara. *(gg)*). It covers both monetary and non-monetary obligations, obligations already incurred at the time of the extension of the credit and obligations incurred thereafter, if the security agreement so provides. However, as there is no secured obligation in an outright transfer of a receivable, the provisions that refer to a “secured obligation” do not apply to an outright transfer of a receivable.

Securities

65. The definition of the term “securities” in the Model Law is narrower than the definition of the term in article 1, subparagraph *(a)*, of the Unidroit Securities Convention (see art. 2, subpara. *(hh)*). While a broad definition is appropriate for the purposes of that Convention, a broad definition for the purposes of the Model Law could result in overlap with movable assets in the form of money, receivables, negotiable instruments or other generic intangible assets for which the Model Law sometimes provides different asset-specific rules to the rules applicable to non-intermediated securities. In any case, an enacting State will need to coordinate the

definition of the term “securities” in its secured transactions law with the definition of the term in its law governing the transfer of securities. The definition of the term “securities” may also differ from the definition of the term as it is used in laws that regulate trading in securities, as the policies that inform the meaning of the term “securities” in that context may be different from the policies of the Model Law (e.g. the policy underlying the definition of that term in those other laws is not to regulate creation of security rights in individual securities but rather to protect the integrity of the enacting State’s capital markets).

Securities account

66. The definition of the term “securities account” in the Model Law is derived from article 1, subparagraph (c), of the Unidroit Securities Convention (see art. 2, subpara. (ii)). It refers to an account, which is maintained with a securities intermediary and to which securities may be credited or debited.

Security agreement

67. The term “security agreement” is defined as an agreement that provides for the creation of a security right (see art. 2, subpara. (jj)). In line with the functional, integrated and comprehensive approach to secured transactions adopted by the Model Law (see para. 17 above), an agreement is a security agreement if it provides for the creation of a property right in a movable asset to secure the payment or other performance of an obligation, even if the parties do not refer to that property right as a security right. Thus, a retention-of-title sales agreement treated as a security agreement as it provides for the creation of a property right that secures the buyer’s obligation to pay the purchase price. Similarly, other types of transaction that rely on the creditor’s ownership to secure an obligation are also security agreements, such as a financial lease or a sale by a debtor to its creditor of an asset subject to the right of the debtor to redeem ownership on payment of the debt owing. As the provisions of the Model Law also apply to outright transfers of receivables by agreement, the term “security agreement” also includes an agreement for the outright transfer of receivables.

Security right

68. The term “security right” is defined as a property right that is created by agreement to secure payment or other performance of an obligation (see art. 2, subpara. (kk)). In line with the functional, integrated and comprehensive approach adopted in the Model Law (see paras. 17 and 67 above), it is irrelevant whether

the parties have denominated the right as a security right or whether they have used wording that refers to a security right. Thus, the term encompasses the ownership right of a buyer/creditor under a sale of an asset by a grantor/seller for security purposes. It also encompasses the ownership right of a seller under a sale subject to a retention-of-title to secure the price and the ownership right of a lessor under a financial lease. As the provisions of the Model Law also apply to outright transfers of receivables by agreement, the term “security right” also includes the right of the transferee under an outright transfer of a receivable by agreement.

Tangible asset

69. The term “tangible asset” in the Model Law includes money, negotiable instruments, negotiable documents in paper form and certificated non-intermediated securities (even though the latter two instruments embody intangible rights), except for the purposes of certain articles that contain rules that are not appropriate for these types of asset (see art. 2, subpara. (ll)). For example, the term “tangible asset” in the definition of the term “mass” (see art. 2, subpara. (s)) does not include negotiable documents because negotiable documents cannot be part of a mass as they are not fungible and therefore cannot be commingled with other documents in a manner that causes them to lose their separate identity.

Writing

70. The definition of the term “writing” is intended to ensure that where that term is referred to in the Model Law (see art. 2, subparas. (g) and (x), art. 6, para. 3, art. 63, paras. 2 and 9, art. 65, paras. 1 and 2, art. 77, para. 2 (a), art. 78, para. 4 (b) and art. 80, paras. 1, 2 (b), 4 and 6, of the Model Law, as well as art. 2, paras. 1-3, and art. 20, para. 5, of the Model Registry Provisions), this reference will include electronic communications (see art. 2, subpara. (nn)). The definition is based on recommendation 11 of the Secured Transactions Guide, which in turn is based on article 9, paragraph 2, of the United Nations Convention on the Use of Electronic Communications in International Contracts (the “Electronic Communications Convention”). However, the Model Law does not include a provision on the electronic equivalent of signature along the lines of recommendation 12 of the Secured Transactions Guide, which is in turn based on article 9, paragraph 3, of the Electronic Communications Convention. For the purpose of the articles of the Model Law that refer to signature (see art. 6, para. 1, and art. 65, paras. 1 and 2), the enacting States may wish to consider whether to include in their enactment of the Model Law an article along the lines of recommendation 12 of the Secured Transactions Guide.

International obligations of the enacting State

71. The Model Law leaves it to the enacting State to decide, in the case of a conflict between a provision of the Model Law and a provision of any treaty or other form of agreement to which an enacting State is a party with one or more other States, whether the requirements of the treaty or agreement are to prevail (see art. 3 of the UNCITRAL Model Law on Cross-Border Insolvency). This matter needs to be considered only in respect of international treaties that directly address matters governed by the Model Law. In States, in which international treaties are not self-executing but require internal legislation to become law, such an approach might be inappropriate or unnecessary (see Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency, paras. 91-93).

Article 3. Party autonomy

72. Article 3, paragraphs 1 and 2, reflects the rules in article 6 of the Assignment Convention and recommendation 10 of the Secured Transactions Guide. Paragraph 1 is intended to reflect the principle that, except for the provisions listed in paragraph 1, parties are free as between themselves to vary by agreement the effect of the provisions of the Model Law. An agreement derogating from the provisions of the Model Law or varying its terms may be between any two parties whose rights are affected by the Model Law (e.g. between the secured creditor and the grantor, between the secured creditor and a competing claimant, between the secured creditor and the debtor of an encumbered receivable, or between the grantor and the debtor of the receivable).

73. The provisions listed in paragraph 1 that are not subject to contrary agreement relate to matters that affect the rights of third parties or reflect a fundamental policy of such importance that their application should be mandatory. In particular, article 4 sets out the general standard of conduct with which all persons must comply when exercising their rights and performing their obligations under the Model Law; article 6 establishes the requirements for the creation of a security right; article 9 deals with the standard for the description of encumbered assets and secured obligations; articles 53 and 54 (see paras. 370-375 below) deal with the obligations of the party in possession of an encumbered asset to exercise reasonable care and the obligation of the secured creditor to return encumbered assets in its possession; and article 72, paragraph 3 (see para. 424 below), prohibits a pre-default waiver of rights of the grantor and the debtor under the enforcement provisions of the Model Law in order to avoid abuse at the time of the conclusion of the security agreement. In addition, articles 85-100 (see paras. 473-524 below) set out the conflict-of-laws rules applicable to the creation, third-party effectiveness,

priority and enforcement of security rights, as well as to the rights and obligations of third-party obligors. Application of the law designated by these rules is mandatory and cannot be avoided by the parties' choice of a different law to ensure certainty with regard to the law applicable to these matters, which are bound to affect the rights of third parties, or the rights of the grantor and the debtor. Articles 101-107 (see paras. 525-548 below) deal with transition to the new law and its application to security rights created under prior law, and are also mandatory to ensure a fair and orderly transition process.

74. Paragraph 2 reiterates the general principle of contract law that an agreement between two parties cannot affect the rights of a third party. For example: (a) if one of two debtors of the same encumbered receivable agrees with the grantor, pursuant to article 65, not to raise certain defences against the secured creditor, that agreement does not bind the other debtor of the receivable, nor does it prevent that debtor from raising those defences as against another person who otherwise would have a prior right to payment of the receivable under article 63, paragraph 4 (see para. 401 below); and (b) if SC1, SC2 and SC3 have a security right in the same encumbered assets in that order of priority, and SC1 agrees to subordinate its security right to that of SC3, their agreement cannot affect the rights of SC2. The reason for reiterating this general principle of contract law is that the Model Law deals with relationships in which an agreement between two parties (e.g. the grantor and the secured creditor) might otherwise appear to have an undue impact on the rights of third parties (e.g. other creditors of the grantor).

75. Paragraph 3 makes clear that, if other law allows the parties to a security agreement to agree to resolve any dispute with respect to their security agreement or a security right created by that agreement by arbitration, mediation, conciliation and online dispute resolution, nothing in the Model Law affects that agreement. Paragraph 3 is based on the understanding that the use of alternative dispute resolution mechanisms to resolve such disputes is important, particularly for countries with inefficient judicial enforcement mechanisms to attract investment, since the lack of efficient judicial enforcement mechanisms is likely to have a negative impact on the availability and the cost of credit. It should be noted that, while paragraph 3 is intended to recognize the importance of alternative dispute resolution mechanisms, it does not prejudice the discussion of arbitrability, the protection of rights of third parties or access to justice.

Article 4. General standards of conduct

76. Article 4 reflects the rules in recommendation 131 of the Secured Transactions Guide (see chap. VIII, para. 15). It is included in chapter I on the scope of application and general provisions, rather than in chapter VII on enforcement, as

it states standards of conduct with which parties should comply when they exercise their rights and perform their obligations under the Model Law, even outside the context of enforcement. Under article 4, a person must exercise all its rights and perform all its obligations under the Model Law in good faith and in a commercially reasonable manner. A breach of this obligation may result in liability for damages and other consequences that are left to the relevant law of the enacting State.

77. The concept of “commercial reasonableness” is not defined in the Model Law but it is generally understood to refer to actions that a reasonable person would take in circumstances similar to those encountered in a particular case by a person exercising a right or performing an obligation under the Model Law. While the standard is an objective one, depending on the circumstances and the type of right or obligation involved, a range of actions may meet the objective standard of “commercial reasonableness”. It should be noted that satisfying a specific standard referred to in a provision of the Model Law (e.g. art. 78, para. 4, and para. 448 below, according to which a notice of the intended disposition of an encumbered asset must be given by the enforcing secured creditor before the expiry of the time period specified by the enacting State) should generally be sufficient to meet the general standards of conduct referred to in this article. It should also be noted that article 4 is listed in article 3 as a mandatory rule. As a result, the duty to act in good faith and in a commercially reasonable manner cannot be waived or varied by agreement. Thus, a term of a security agreement stating that the parties agree that a particular course of action is commercially reasonable is not effective if the specified course of action is not in fact commercially reasonable from an objective perspective.

Article 5. International origin and general principles

78. Article 5 is inspired by article 7 of the CISG and article 3 of the UNCITRAL Model Law on Electronic Commerce, article 4 of the UNCITRAL Model Law on Electronic Signatures and article 2A of the UNCITRAL Model Law on International Commercial Arbitration. It is intended to provide guidance in the interpretation of the Model Law. The expected effect of article 5 is to limit the extent to which the Model Law, once incorporated in national law, would be interpreted only by reference to concepts of national law.

79. The purpose of the reference in paragraph 1 to the international origin of the Model Law is to draw the attention of any person that might be called upon to interpret and apply a national law implementing the Model Law to the fact that its provisions, while part of a national law, should be interpreted and applied in a manner that will promote uniformity among all enacting States. Good faith in

paragraph 1 is a consideration to be taken into account in the interpretation of the Model Law. In contrast, reference to good faith in article 4 sets a standard to be complied with by all persons in the exercise of their rights and the performance of their obligations under the Model Law.

80. Under paragraph 2, any gaps in a law implementing the Model Law are to be filled by reference to the general principles on which the Model Law is based. As already noted (see paras. 5 and 18 above), the primary objective of (or general principle underlying) the Model Law is to enhance the availability of credit at more affordable rates (for a complete statement and discussion of the key objectives of an effective and efficient secured transactions law, see Secured Transactions Guide, rec. 1 and Introduction, paras. 43-59).

Chapter II. Creation of a security right

A. General rules

81. This chapter contains a section A with general rules and a section B with asset-specific rules. The distinction between general and asset-specific rules is adopted in chapters III (third-party effectiveness), V (priority), VI (rights and obligations of the parties and third-party obligors), VII (enforcement) and VIII (conflict of laws). This distinction is adopted to avoid overloading the general rules with asset-specific details. The general rules apply to all assets, but, in relation to certain types of asset, they apply subject to the asset-specific rules. The enacting State may wish to consider whether to include in the general rules of each chapter of its law cross-references to the asset-specific rules or a provision that states explicitly that the general rules in each chapter are subject to the asset-specific rules (see footnote 4 of the Model Law). Enacting States are encouraged to enact the Model Law in its entirety, including the asset-specific rules (particularly those relating to core commercial assets, such as receivables). Enacting States should only consider omitting asset-specific rules if they relate to assets that are unlikely to serve as the basis for secured credit in that State.

Article 6. Creation of a security right and requirements for a security agreement

82. Article 6 is generally based on recommendations 13-15 of the Secured Transactions Guide (see chap. II, paras. 12-37). Its purpose is to state the requirements for the creation of a security right, as well as the form and the minimum content of a security agreement, so as to enable parties to obtain a security right in a simple and efficient manner (see Secured Transactions Guide, rec. 1, subpara. (c)).

83. Under paragraph 1, a security right is created by a security agreement, for the conclusion of which no terms of art or special words need be used (see art. 2, subpara. (jj), and para. 67 above). The creation of a security right is subject to the condition that the grantor has either rights in the asset to be encumbered or the power to encumber it. The term “rights” is not limited to ownership rights. For example, if the grantor is in possession of the asset on the basis of an agreement, such as a lease agreement, with the owner of the asset, the grantor has a right to create a security right in its rights under the lease agreement.

84. A person may have the power, by operation of other law or by agreement with the owner, to grant a security right in an asset in which it has no rights or only limited rights. A person may also have this power by implication from the operation of the third-party effectiveness and priority rules of the Model Law. For example, a financial lease is a security right under the Model Law's functional concept of security right; and it is the clear intent of these rules that a lessor's ownership rights could be ineffective against or rank behind another secured creditor of the lessee in certain circumstances (e.g. if the lessor fails to make its right in the leased asset effective against third parties at all or in a timely fashion; see arts. 18 and 38). For these third-party effectiveness and priority rules to apply, the lessee must have the power to encumber the leased asset in favour of the other secured creditor, even though it only has possessory rights in the asset as against the lessor.

85. A similar result may apply where the creditor of a receivable transfers the receivable outright to A and then purports to create a security right in that same receivable to B. Since the third-party effectiveness and priority rules of the Model Law apply to outright transfers of receivables by agreement, it follows that, if A does not make its right effective against third parties before B does so, B will have priority over A. For this to be the case, the grantor needs to have the power to create a security right in favour of B even if it had previously transferred all its rights in the receivables to A.

86. It should also be noted that, in line with article 13, paragraph 1 (see para. 109 below), a creditor of a receivable to which that article applies has the right to encumber it despite any anti-assignment agreement with the debtor of the receivable.

87. Paragraph 2 clarifies that a security agreement may provide for the creation of a security right in future assets (i.e. assets produced or acquired by the grantor after the conclusion of the security agreement; see definition in art. 2, subpara. (n)). However, the security right is created in the future assets only when the grantor acquires rights in them or the power to encumber them.

88. Paragraph 3 states that a writing signed by the grantor is required for a security agreement and sets out the minimum contents of the writing. Written form provides objective evidence of the existence of a security agreement and its key terms (for other reasons why a written security agreement might be required, see Secured Transactions Guide, chap. II, para. 30). From the two alternative wordings set out in the chapeau of paragraph 3 within square brackets, the enacting State may wish to select the one that best fits with its contract law and its law of evidence. If the enacting State selects the words "concluded in", a security agreement that is not in a writing signed by the grantor will not be effective, unless the secured creditor has possession of the encumbered assets (see art. 6, para. 4, see para. 90

below). For example, a written offer by the secured creditor that is subsequently accepted by the grantor by conduct would not be a sufficient security agreement under this option. If the enacting State retains the words “evidenced by”, however, a security agreement that is not in a writing signed by the grantor would still be effective if its terms are evidenced by a written document signed by the grantor (i.e. an oral agreement that is subsequently confirmed in writing).

89. Depending on what it considers as the most efficient financing practices and on reasonable expectations of local credit market participants, an enacting State may wish to consider whether to retain the requirement for a security agreement to specify the maximum amount for which the security right may be enforced (set out in brackets in paragraph 3 (*d*)). The rationale for this requirement is to facilitate the grantor’s access to secured financing from other creditors in situations where the value of the assets encumbered by the prior security right exceeds the maximum amount agreed to by the parties in their security agreement. Another approach is to leave out paragraph 3 (*d*), in order to facilitate the grantor’s access to credit from the initial secured creditor (for the comparative advantages and disadvantages of the two approaches, see Secured Transactions Guide, chap. IV, paras. 92-97, and Registry Guide, paras. 200-204). If paragraph 3 (*d*) is retained, the enacting State will need to require the maximum amount to be set out in the notice registered in relation to that security agreement (see art. 8, subpara. (*e*), of the Model Registry Provisions, and para. 176 below). Otherwise the objective of paragraph 3 (*d*) would not be realized because the maximum amount would not be disclosed to potential subsequent secured creditors upon a search of the registry record (art. 24, para. 7, of the Model Registry Provisions would also need to be retained to deal with an error in stating the maximum amount in the notice).

90. Under paragraph 4, where the secured creditor is in possession of the encumbered asset, an oral security agreement with the grantor is sufficient for a security right to be created. This is because the fact that the secured creditor is in possession of the encumbered asset is itself evidence that the grantor may not have unencumbered ownership (see Secured Transactions Guide, chap. II, para. 33).

Article 7. Obligations that may be secured

91. Article 7 is based on recommendation 16 of the Secured Transactions Guide (see chap. II, paras. 38-48). It is primarily intended to ensure that any type of obligation may be secured, including future, conditional or fluctuating obligations. The main reason for this approach is to facilitate modern financing transactions, in which secured obligations are not necessarily present, unconditional or fixed since disbursements of funds by the secured creditor need to be made at different times depending on the needs of the grantor (e.g. revolving credit facilities for the grantor to buy inventory).

Article 8. Assets that may be encumbered

92. Article 8 is based on recommendation 17 of the Secured Transactions Guide (see chap. II, paras. 49-57 and 61-70). It is primarily intended to ensure that future movable assets, parts of movable assets or undivided rights in movable assets, generic categories of movable assets, as well as all the movable assets of a person, may be the subject of a security agreement (for the time when a security right in future assets is created, see art. 6, para. 2, and para. 87 above).

93. The fact that future movable assets may be subject to a security right does not mean that statutory limitations on the creation or enforcement of a security right in specific types of movable asset (e.g. employment benefits in general or up to a specific amount) are overridden (see art. 1, para. 6, and para. 31 above). However, any such limitations should be limited and described in the law in a clear and specific way (see Secured Transactions Guide, rec. 17).

94. The fact that all the movable assets a person has may be subject to a security right so as to maximize the amount of credit that may be available and improve the terms of the credit agreement does not mean that other creditors of the grantor are necessarily unprotected. The protection of other creditors (within and outside insolvency proceedings) is a matter for other law and is referred to in articles 35 and 36 (see paras. 312-316 below).

Article 9. Description of encumbered assets and secured obligations

95. Article 9 is based on recommendation 14 (*d*) of the Secured Transactions Guide (see chap. II, paras. 58-60). For purposes of clarity and organization, the standard for the description of encumbered assets in a security agreement is presented in a separate article (rather than in art. 6, para. 3, as it was done in rec. 14 (*d*) of the Secured Transactions Guide). Article 9 extends the standard to the description of secured obligations.

96. Paragraph 1 sets out the standard that must be met for the description of encumbered assets and the secured obligations in a security agreement to be effective (the description must reasonably allow their identification). Paragraph 2 is intended to ensure that, if a security right is created in a generic category of assets under article 8, subparagraph (*c*), a generic description in the security agreement, such as “all inventory” or “all receivables”, is sufficient to meet the standard in paragraph 1 (see Secured Transactions Guide, chap. II, paras. 58-67; for the description of encumbered assets in a notice, see art. 11 of the Model Registry Provisions. and paras. 185-188 below). Paragraph 3 similarly recognizes

that a description of the secured obligation as all obligations owed to the secured creditor at any time likewise meets the standard in paragraph 1 (see Secured Transactions Guide, chap. II, para. 46).

Article 10. Rights to proceeds and commingled funds

97. Article 10 is based on recommendations 19 and 20 of the Secured Transactions Guide (see chap. II, paras. 72-89). Paragraph 1 is intended to ensure that, unless otherwise agreed by the parties (as this article is not listed in art. 3 as a mandatory law rule; the same applies to other articles not listed in art. 3 as mandatory law rules), a security right in an asset automatically extends to its identifiable proceeds, including identifiable proceeds of proceeds (for the definition of “proceeds” see art. 2, subpara. (bb), and para. 59 above). Otherwise, a grantor could effectively deprive a secured creditor of its security by disposing of the encumbered assets either to a person who would take free of the security right or to a person from whom those assets could not easily be recovered.

98. Under the Model Law, unless the buyer or other transferee acquires the encumbered asset free of the security right (see, for example, art. 34, para. 4, and para. 306 below), the secured creditor has the right to enforce its security right both in the original encumbered asset and in the proceeds up to the amount of the secured obligation outstanding at the time of enforcement, even when that amount is greater than the value of the original encumbered asset at the time of disposition. The rationale for this rule is that it reflects the normal expectations of the parties (see Secured Transactions Guide, chap. II, para. 85).

99. For example, where the original encumbered asset is inventory, receivables generated from the sale of the inventory are proceeds (if they are identifiable). If the funds received on payment of the receivables are deposited in a bank account, the right to payment of the funds credited to the bank account is also proceeds (proceeds of proceeds of the inventory). So, too, is a right to payment pursuant to a negotiable instrument (e.g. a cheque drawn by the holder of that bank account to buy new inventory). If the description of the encumbered asset in the security agreement is sufficiently comprehensive to cover all assets received in respect of the original encumbered asset, they will be both original encumbered assets and proceeds.

100. As a security right under paragraph 1 extends only to “identifiable” proceeds, a security right in proceeds terminates once it is no longer possible to identify the relevant asset as derived from the original encumbered asset or its identifiable proceeds. Paragraph 2 introduces an exception to the identifiability requirement in paragraph 1 where proceeds in the form of money are

commingled with other money of the same currency or funds credited to a bank account are commingled with other funds deposited to that account. Even though the proceeds cannot be identified separately from the other money or fund, paragraph 2 (a) provides that the security right in the proceeds extends to the commingled money or funds. However, paragraph 2 (b) limits that security right to the value of the proceeds immediately before they were commingled. For example, if proceeds in the amount of €1,000 are deposited to a bank account that has a credit balance of €1,500 or to which €1,500 are deposited, the security right in the proceeds extends only to €1,000, subject to the limitation in paragraph 2 (c).

101. Paragraph 2 (c) deals with situations in which money or funds are withdrawn after the proceeds are commingled so that at some point of time, the total amount of money or funds is less than the amount of the proceeds (in the example set out in the previous paragraph, less than €1,000). Even if money or funds are subsequently added, the security right extends only to the lowest amount between the time when the proceeds were commingled and the time the security right in the proceeds is claimed. So, in the example given in the previous paragraph, if the balance in the bank account immediately after the proceeds were deposited was €1,500, then it went down to €500 and at the time of enforcement was €750, the security right extends only to €500 (i.e. the lowest intermediate balance). The rationale for this approach is that, if the credit balance of a bank account or the total amount of commingled money falls below the amount of the proceeds, funds deposited or money added thereafter cannot be deemed to be proceeds of the original encumbered assets.

102. Where funds in a bank account are original encumbered assets, and the funds are transferred into another bank account of the grantor and mixed with other funds in that other account, then the funds transferred into that other account will be “proceeds” of the original encumbered assets, and thus the rules in article 10 will apply.

Article 11. Tangible assets commingled in a mass or transformed into a product

103. Article 11 is generally based on recommendations 22 and 91 of the Secured Transactions Guide (see chap. II, paras. 90-95 and 100-102, and chap. V, paras. 117-123). It accomplishes two objectives. First, paragraph 1 provides that a security right in a tangible asset that is commingled with other assets of the same kind in a mass, or transformed into a product extends to the mass or product (for the definitions of the terms “mass” and “product”, see art. 2, subparas. (s) and (cc)). Second, paragraphs 2 and 3 limit the value of that security right albeit in different

ways. Article 33 then addresses situations in which more than one secured creditor has a claim to a mass or product under article 11.

104. Under paragraph 2, a security right in a tangible asset that extends to a mass under paragraph 1 is limited to the same proportion of the mass that the asset bore to the quantity of the entire mass immediately after it was commingled in the mass. Thus, if a secured creditor has a security right in 100,000 litres of oil that is commingled with 50,000 litres of oil in the same tank so that the mass comprises 150,000 litres of oil, the security right is limited to two-thirds of the oil in the tank (i.e. 100,000 litres). If the quantity of the oil in the tank decreases, the secured creditor will have a security right in only two-thirds of the oil in the tank. For example, if only 75,000 litres remain in the tank, then the secured creditor will have a security right in only two-thirds of those 75,000 litres, namely in 50,000 litres.

105. The limit on the secured creditor's security right in the mass under paragraph 2 is set by reference to the quantity of the asset, rather than its value. Decreases or increases in the value of the asset are therefore irrelevant to the rule in paragraph 2. Thus, in the example in the previous paragraph, the value of the security right in the oil will decrease if the value of the oil in the tank goes down and correspondingly increase if the value of the oil in the tank goes up. This reflects commercial expectations, as it puts the secured creditor in the same position that the secured creditor would have been in if the oil had not been commingled in the tank with other oil in the first place.

106. Paragraph 3 addresses the situation where the encumbered tangible assets are transformed into a product rather than being commingled in a fungible mass. Under paragraph 3, the security right in the product is limited by reference to the value, rather than the quantity, of the encumbered assets immediately before they became part of the product. Otherwise, the secured creditor would obtain a windfall gain if the value of the finished product were greater than the value of its components (e.g. because of value that is added by the debtor's production efforts including the labour of its employees; see Secured Transactions Guide chap. II, para. 94). In addition, assets that contribute to a product may be of different types and so a quantitative comparison is not appropriate. Thus, if encumbered gold worth €100 is fashioned into a ring worth €500, or encumbered flour worth €100 is mixed with yeast to make bread worth €500, the security right is limited to €100.

Article 12. Extinguishment of security rights

107. Under article 12, a security right is extinguished only where there is full payment or other satisfaction of all secured obligations and there is no longer any commitment on the part of the secured creditor to extend further credit secured

by the security right. For example, if a security right secures an amount owed under a revolving credit agreement, the security right is not extinguished simply because temporarily there may be no amount outstanding, since there is still a potential future obligation by virtue of the commitment of the secured creditor to extend further credit.

108. The extinguishment of a security right triggers the obligation of a secured creditor in possession to return the encumbered asset, or of a secured creditor that has registered a notice of its security right, to register an amendment or cancellation notice (see art. 54 of the Model Law, and paras. 373-375 below), as well as art. 20, para. 3 (c), of the Model Registry Provisions, and para. 214 below).

B. Asset-specific rules

Article 13. Contractual limitations on the creation of security rights in receivables

109. Article 13 is based on recommendation 24 of the Secured Transactions Guide (see chap. II, paras. 106-110 and 113), which in turn is based on article 9 of the Assignment Convention. Paragraph 1 provides that an agreement limiting the grantor's right to create a security right in the receivables listed in paragraph 3 (often referred to as "trade receivables") does not prevent a security right created by the grantor from being effective. The rationale underlying this approach is to facilitate the use of receivables as security for credit (see para. 112 below), which is in the interest of the economy, without unduly interfering with party autonomy. This rule does not affect statutory limitations on the creation or enforcement of a security right in certain types of receivable (e.g. consumer or sovereign receivables; see art. 1, paras. 5 and 6, and paras. 30 and 31 above).

110. The agreement referred to in paragraph 1 may have been entered into: (a) between the initial creditor/grantor and the debtor of the receivable (e.g. where the encumbered receivable is the claim of a seller for the outstanding balance of the purchase price, an agreement between the seller and the buyer); (b) where the initial creditor/grantor transfers the receivable to another person and that person creates a security right in the receivable, between that person (referred to in article 13 as a subsequent grantor) and the debtor of the receivable (e.g. where the seller sells the receivable to A and A creates a security right in favour of B, an agreement between A and the debtor of the receivable); (c) between the initial creditor/grantor and the initial secured creditor (e.g. an agreement between the seller and A); and (d) where the initial creditor/grantor transfers the receivable to a person and that person creates a security right, between that person (referred to

in art. 13 as a subsequent grantor) and any secured creditor who obtained a security right from that person (referred to in art. 13 as a subsequent secured creditor; e.g. an agreement between A and B).

111. Paragraph 2 makes it clear that, while under paragraph 1 a security right is effective notwithstanding an agreement to the contrary, a person that creates a security right in a receivable in breach of that agreement is not excused from any liability to its counter-party for damages caused by breach of that contractual provision, if there are such damages and such liability exists under other law. Thus, for example, if the debtor of a receivable has sufficient negotiating power to convince the creditor of the receivable to consent to an anti-assignment agreement, and the creditor creates a security right in the receivable despite that agreement in a way that results in a loss to the debtor of the receivable, the creditor may be liable to the debtor of the receivable for damages under the law of the State whose law governs that agreement. However, the debtor of the receivable may not avoid the contract because of that breach or raise against the secured creditor (including an outright transferee), by way of set-off or otherwise, any claim it may have against the grantor (including an outright transferor) for that breach. In addition, under paragraph 2, a secured creditor that accepts a receivable as security for credit is not liable to the debtor of the receivable for such a breach just because it had knowledge of the anti-assignment agreement. Otherwise, the anti-assignment agreement would in effect prevent a secured creditor from obtaining a security right in a receivable covered by the anti-assignment agreement.

112. One of the benefits of the rules in paragraphs 1 and 2 is that a secured creditor does not have to review each contract from which a receivable might arise to determine whether it contains a contractual limitation on assignment that may affect the effectiveness of a security right. This facilitates transactions relating to pools of existing receivables (with respect to which a review of the underlying transactions at the time of the conclusion of the security agreement is possible but which is not necessarily time- or cost-efficient), as well as transactions relating to future receivables (with respect to which such a review would not be possible at the time of the conclusion of the security agreement, with the result that future receivables would not be accepted by lenders as security for credit).

113. Paragraphs 3 (a) to (c) limit the scope of the rule in paragraph 1 to what could broadly be described as trade receivables. The rule does not apply to other types of receivables, such as receivables arising from loans. This is for the following reasons. First, the interference with party autonomy effected by the rule in paragraph 1 is most strongly justified in the case of trade receivables (see para. 109 above). Second, in relation to receivables arising from loans, there is a much greater reason for the debtor of the receivable to wish to preclude anybody other than the lender from being able to collect the receivable, since the debtor's relationship with

the lender is likely to be ongoing.

114. Receivables arising from financial contracts governed by netting agreements are generally excluded from the scope of the Model Law, except the receivable arising upon the termination of all outstanding transactions (see art. 1, para. 3 (d)). Under paragraph 3 (d), the rule in paragraph 1 applies to receivables arising upon net settlement of payments due pursuant to a multilateral netting agreement. Both the exclusion in article 1, paragraph 3 (d) and the exception in article 13, paragraph 3 (d) are line with articles 4, paragraph 2 (b), and 9, paragraph 3 (d), of the Assignment Convention.

115. Article 13 applies also to anti-assignment agreements limiting the creation of a security right in any personal or property rights securing or supporting payment or other performance of an encumbered intangible asset other than a receivable or an encumbered negotiable instrument (see art. 14, and paras. 116-118 below).

Article 14. Personal or property rights securing or supporting payment or other performance of encumbered receivables or other intangible assets, or negotiable instruments

116. The first sentence of article 14 reflects the thrust of recommendation 25 of the Secured Transactions Guide (see chap. II, paras. 111-122), which in turn is based on article 10 of the Assignment Convention. It is intended to ensure that a secured creditor with a security right in the types of asset described in article 14 automatically has the benefit of any personal or property right that secures or supports payment or other performance of those types of asset. For example, a personal or property right that secures payment of a receivable may be an accessory or secondary guarantee (or suretyship) or a security right in movable or immovable property; and a personal right that supports payment of a receivable may be an independent guarantee or a stand-by letter of credit. For example, in some States, if the performance of a receivable is secured by a personal guarantee or by a security right in movable or immovable property, the secured creditor with a security right in that receivable obtains the benefit of that personal guarantee or security right. This means that, if the receivable is not paid, the secured creditor may seek payment from the guarantor or enforce the security right in accordance with the relevant law and the terms of the guarantee or the security right.

117. Article 14 does not include the substance of recommendation 25 (g) of the Secured Transactions Guide because this matter is addressed in articles 61 and 68 (see paras. 392-394 and 414). Neither does article 14 include the substance of recommendation 25 (h) of the Secured Transactions Guide (which was based on art. 10, para. 6, of the Assignment Convention) because it should be self-evident

that the article does not affect any requirement under other law relating to the creation of a security right in a type of asset that is not covered by the Model Law (e.g. a rule of immovable property law under which registration of an encumbrance on the relevant immovable property registry is a condition of its creation).

118. The second sentence of article 14, which reflects the thrust of article 10, paragraph 1, of the Assignment Convention, is necessary because, under other law in some States, certain personal or property rights that secure or support payment or other performance of a receivable or other intangible asset, or a negotiable instrument may be transferable only with a new act of transfer. In such a case, article 14 does not override the other law but instead obliges the grantor to transfer the benefit of that right to the secured creditor.

Article 15. Rights to payment of funds credited to a bank account

119. Article 15 reflects the thrust of recommendation 26 of the Secured Transactions Guide (see chap. II, paras. 123-125). It implements the principles underlying article 13 with respect to rights to payment of funds credited to a bank account (see paras. 109 and 112 above). Under article 15, a security right may be created in a right to payment of funds credited to a bank account even if there was an agreement between the grantor and the deposit-taking institution prohibiting the creation of a security right. However, article 69 provides that the creation of such a security right does not affect the rights and obligations of the deposit-taking institution and, in particular, does not obligate the deposit-taking institution to provide any information about the bank account to third parties (see paras. 415-418 below).

Article 16. Negotiable documents and tangible assets covered by negotiable documents

120. Article 16 is derived from recommendation 28 of the Secured Transactions Guide (see chap. II, para. 128). It reflects the broadly accepted principle that a negotiable document is treated as embodying rights in the tangible assets covered by the document. As a result, a security right in those tangible assets may be created by creating a security right in the document. For example, a security right in cargo covered by a negotiable bill of lading issued by the carrier or in assets covered by a negotiable warehouse receipt issued by the operator of the warehouse in which those assets have been deposited may be created by creating a security right in the bill of lading or warehouse receipt.

121. Under article 16, a security right in a negotiable document extends to the assets covered by the document only if the issuer of the document is in possession of the assets when the security right is created. If this condition is satisfied, the security right in the tangible assets covered by the document continues to exist even after the assets are no longer in the possession of the issuer of the negotiable document. However, under article 26, paragraph 2, the effectiveness of the security right in the assets against third parties that was achieved by possession of the document applies while the document covers the assets and lapses once possession of the assets is relinquished by the issuer (see para. 138 below).

Article 17. Tangible assets with respect to which intellectual property is used

122. Article 17 is based on recommendation 243 of the Intellectual Property Supplement (see paras. 108-112). It is intended to recognize the distinction between a tangible asset with respect to which intellectual property is used and the intellectual property (e.g. a motor vehicle that incorporates features that rely on the manufacturer's right to use a patented invention or copyrighted software as distinct from the patent or copyright itself). As a result, a secured creditor who has a security right in a tangible asset with respect to which intellectual property is used does not acquire a security right in the intellectual property, unless the intellectual property is included in the description of the encumbered assets in the security agreement and then only if the grantor has rights, or the power to create a security right, in the relevant intellectual property (see art. 6, paras. 1 and 3(c), and art. 9, para. 1, as well as paras. 83 and 96 above).

Chapter III. Effectiveness of a security right against third parties

A. General rules

Article 18. Primary methods for achieving third-party effectiveness

123. Article 18 is based on recommendations 32 and 37 of the Secured Transactions Guide (see chap. III, paras. 19-86). It sets out the primary methods for achieving the third-party effectiveness of a security right. The first is registration of a notice of the security right in the Registry established under article 28. This method is available for all types of movable asset to which the Model Law applies. The second is physical possession of a tangible encumbered asset by the secured creditor (for the definition of the term “possession”, see art. 2, subpara. (z), and para. 56 and 57 above). As intangible assets are not be capable of physical possession and as possession is defined in the Model Law by reference to tangible assets only, this method is available only for security rights in tangible assets. Alternative methods of third-party effectiveness, such as a control agreement for security rights in rights to payment of funds credited to a bank account and in non-intermediated securities are set out in the asset-specific provisions of this chapter (see arts. 25 and 27, and paras. 135, 136 and 140 below).

124. In practice, registration is the most commonly used method for achieving third-party effectiveness of a security right, both because it is available for all types of encumbered asset and because it allows the grantor to remain in possession of and to continue to use the encumbered asset. Registration is also the basis for the predictable, fair and efficient ordering of priority among competing security rights in the same asset under the general priority rule of the Model Law according to which priority is determined according to the order of registration (see art. 29, and paras. 285-293 below).

Article 19. Proceeds

125. Article 19 is generally based on recommendations 39 and 40 of the Secured Transactions Guide (see chap. III, paras. 87-96). It addresses the circumstances in

which the security right in identifiable proceeds of an encumbered asset that is provided for in article 10 is effective against third parties.

126. Under paragraph 1, if a security right in an asset is effective against third parties, a security right in its identifiable proceeds is automatically effective against third parties, if the proceeds take the form of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account. For example, upon the sale of inventory that is subject to a security right that is effective against third parties, a security right in any identifiable receivables arising from the sale of the inventory is effective against third parties without any further act.

127. If the assets that constitute the proceeds are of a type that is included in the description of the original encumbered assets in the security agreement, they will constitute both original encumbered assets and proceeds (see para. 99 above). Accordingly, in this situation, the security right in the proceeds will be effective against third parties without the need for any further act if the security right in the proceeds as original encumbered assets was made effective against third parties pursuant to article 18 before the proceeds arose.

128. Except for proceeds of a type covered in paragraph 1, paragraph 2 provides that, if the security right in the original encumbered asset was effective against third parties, the security right in its identifiable proceeds is automatically effective against third parties for the time period specified by the enacting State after the proceeds arose. The period should be sufficient for the secured creditor to find out that proceeds have been generated and take action (such as 20-25 days). Thereafter, the security right in the proceeds continues to be effective against third parties only if it is made effective against third parties before the expiry of that period by one of the methods applicable to encumbered assets of that type. For example, if the proceeds take the form of a tangible asset, the security right in its identifiable proceeds will cease to be continuously effective against third parties if the secured creditor does not take the steps necessary to make its security right effective against third parties prior to the expiry of the time period set out in paragraph 2. While the secured creditor may subsequently make its security right effective against third parties, it will be effective against third parties only from that time forward (see art. 22, and para. 131 below).

Article 20. Tangible assets commingled in a mass or transformed into a product

129. Article 20 is based on recommendation 44 of the Secured Transactions Guide. Its purpose is to ensure that, if a tangible asset subject to a security right that is effective against third parties is commingled in a mass or transformed into

a product, and the security right in the tangible asset extends to the mass or product under article 11, the security right in the mass or product will be automatically effective against third parties. In other words, no separate act is necessary to make the security right in the mass or product effective against third parties. It should be noted that preserving continuity of third-party effectiveness is relevant for the purposes of the priority rules (for the priority of this security right, see arts. 33 and 42, and paras. 297, 298 and 341 below).

Article 21. Changes in the method for achieving third-party effectiveness

130. Article 21 is based on recommendation 46 of the Secured Transactions Guide (see chap. III, paras. 120 and 121). It is intended to ensure that a security right that was initially made effective against third parties by one method (e.g. registration) and that is later made effective against third parties by another method (e.g. possession) remains continuously effective against third parties provided that there is no gap between the time third-party effectiveness was achieved by the first and the second method. It should be noted that preserving continuity of third-party effectiveness is important for the purpose of preserving priority as against competing claimants whose rights arise after the security right is initially made effective against third parties.

Article 22. Lapses in third-party effectiveness

131. Article 22 is based on recommendation 47 of the Secured Transactions Guide (see chap. III, paras. 122-127). It is intended to ensure that, if third-party effectiveness lapses, it may be re-established. In such a case, however, the third-party effectiveness dates only from the time it is re-established and thus priority dates as of that time.

Article 23. Continuity in third-party effectiveness upon a change of the applicable law to this Law

132. Article 23 is based on recommendation 45 of the Secured Transactions Guide (see chap. III, paras. 117-119). It addresses the situation where, under the conflict-of-laws provisions of the Model Law, the law applicable to the third-party effectiveness of a security right changes to that of a State that has enacted the Model Law as a result of a change in the relevant connecting factor, for example, because of a change in the location of the grantor or the encumbered assets (for the relevant time for determining location, see art. 91, and paras. 490-493 below).

Under paragraph 1, a security right that was effective against third parties under the previously applicable law continues to be effective against third parties under the law of the enacting State only if it is made effective against third parties in accordance with that law before the time when third-party effectiveness lapses under the previously applicable law or the expiry of the time period to be specified by the enacting State. The specified period should be sufficient to give the secured creditor an opportunity to find out that the applicable law has changed and take action (e.g. 45-60 days).

133. Under paragraph 2, if the third-party effectiveness of a security right continues under paragraph 1, it dates back to the time it was first achieved under the previously applicable law. If third-party effectiveness is not preserved under paragraph 1, it may be re-established, but third-party effectiveness will then only date from the time it is re-established (see art. 22, and para. 131 above).

Article 24. Acquisition security rights in consumer goods

134. Article 24 is based on recommendation 179 of the Secured Transactions Guide (see chap. IX, paras. 125-128). An acquisition security right (see art. 2, subpara. (b), and para. 38 above) in consumer goods is automatically effective against third parties if the purchase price of the consumer goods is below an amount to be specified by the enacting State. This limitation is intended to exempt from registration security rights in low-value consumer transactions. For this provision to be meaningful, the threshold price for the consumer goods should not be so high as to prevent a consumer from encumbering his or her assets to obtain credit, but not so low as to dissuade a secured creditor from entering into a transaction because the transaction costs associated with ensuring and monitoring the third-party effectiveness of its security right would outweigh the benefits (for the question of when a buyer acquires its rights free of an acquisition security right that is automatically effective against third parties under this article, see art. 34, para. 9, and para. 310 below).

B. Asset-specific rules

Article 25. Rights to payment of funds credited to a bank account

135. Article 25 is based on recommendation 49 of the Secured Transactions Guide (see chap. III, paras. 138-148). Under the general third-party effectiveness rules of the Model Law, the general method for achieving the third-party effectiveness of a security right in an intangible asset is registration of a notice of the

security right (see art. 18, and paras. 123 and 124 above). If the intangible asset is a right to payment of funds credited to a bank account, article 25 provides three additional methods for achieving third-party effectiveness.

136. The availability of these alternatives depends on the type of the secured creditor. If the secured creditor is the deposit-taking institution that holds the bank account, a security right created in its favour is automatically effective against third parties. If the secured creditor is another party, the security right may be made effective against third parties by one of two methods. The first is the conclusion of a control agreement between the grantor, the secured creditor and the deposit-taking institution (for the definition of the term “control agreement”, see art. 2, subpara. (g) (ii), and para. 43 above). The second is by the secured creditor becoming the account holder. The precise action required for the secured creditor to become the account holder will depend on factors, such as the law to which the deposit-taking institution is subject and the terms of the account agreement. It should be noted that these alternative methods of third-party effectiveness have different priority consequences but provide priority that is superior to that achieved by registration (see art. 47, and paras. 352-356 below).

Article 26. Negotiable documents and tangible assets covered by negotiable documents

137. Article 26 is based on recommendations 51-53 of the Secured Transactions Guide (see chap. III, paras. 154-158). It mainly addresses the relationship between the third-party effectiveness of a security right in a negotiable document and the third-party effectiveness of a security right in the tangible assets covered by the document.

138. Under paragraph 1, if a security right in a negotiable document is effective against third parties and the security right extends to the assets covered by the document under article 16, the security right in the assets covered by the document will automatically be effective against third parties. Under paragraph 2, the security right in the assets covered by the document can be made effective against third parties by possession of the document for as long as the assets are covered by the document.

139. Under paragraph 3, a security right in an asset that is made effective against third parties by the secured creditor’s possession of the document remains effective against third parties for a short period of time (such as 10 days) after possession of the document or the asset covered by the document is relinquished to the grantor (or another person) for the purpose of enabling the grantor to sell, exchange, load, unload or otherwise deal with the assets in the course of the grantor’s business.

Article 27. Uncertificated non-intermediated securities

140. As the Secured Transactions Guide does not address security rights in securities of any type (see rec. 4 (c), and para. 26 above), article 27 does not correspond to any of the recommendations of the Secured Transactions Guide. It addresses the methods, other than registration of a notice, by which a security right in uncertificated non-intermediated securities (for the definition of that term, see art. 2, subpara. (mm)) may be made effective against third parties. First, the security right may be made effective against third parties either by a notation of the security right or by the entry of the name of the secured creditor as the holder of the securities in the books maintained by the issuer or by another person on behalf of the issuer for the purpose of recording the name of the holder of securities. The enacting State should choose the method that best fits its legal system; if both methods are used in the enacting State, that State may choose to retain both methods. Second, similarly to the case of a security right in a right to payment of funds credited to a bank account (see paras. 135 and 136 above), the security right may be made effective against third parties by the conclusion of a control agreement between the grantor, the secured creditor and the issuer (for the definition of the term “control agreement”, see art. 2, subpara. 2 (g) (i), and para. 43 above).

Additional considerations for States parties to the Geneva Uniform Law and the Bills and Notes Convention

141. Under article 19 of the Uniform Law provided by the Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 1930; the “Geneva Uniform Law”), “when an endorsement contains the statements ‘value in security’ (‘valeur en garantie’), ‘value in pledge’ (‘valeur en gage’), or any other statement implying a pledge, the holder may exercise all the rights arising out of the bill of exchange, but an endorsement by him has the effects only of an endorsement by an agent”. Article 22 of the United Nations Convention on International Bills of Exchange and International Promissory Notes (the “Bills and Notes Convention”) contains a similar rule, according to which “if an endorsement contains the words ‘value in security’, or any other words indicating a pledge, the endorsee is a holder who: (a) may exercise all rights arising out of the instrument ...”.

142. An enacting State that has enacted the Geneva Uniform Law (or the Bills and Notes Convention) may wish to note that a secured creditor in possession of a negotiable instrument or certificated non-intermediated security may have, in addition to its rights under the Model Law, the rights afforded by the Geneva Uniform Law (or the Bills and Notes Convention) where the instrument or the security contains an endorsement of the kind contemplated by the Geneva Uniform Law (or the Bills and Notes Convention).

Chapter IV. The registry system

Article 28. Establishment of the Registry

143. Article 28 is based on recommendations 1(f) of the Secured Transactions Guide and 1 of the Registry Guide. It provides for the establishment by the enacting State of a public registry to give effect to the provisions of the Model Law relating to the registration of notices with respect to security rights (the “Registry”). In particular, under article 18 of the Model Law, a non-possessory security right in an encumbered asset is effective against third parties, as a general rule, only if a notice with respect to the security right is registered in the Registry (see Secured Transactions Guide, chap. III, paras. 29-46 and the Registry Guide, paras. 20-25). Under article 29 of the Model Law, the time of registration, again as a general rule, is also the basis for determining the order of priority between a security right and the right of a competing claimant (see Secured Transactions Guide, chap. V, paras. 42-50, and the Registry Guide, paras. 36-46).

144. Depending on its drafting conventions, an enacting State may incorporate the provisions relating to the registry system in its secured transactions law implementing the Model Law, in a separate law or other legal instrument, or in a combination thereof. To preserve flexibility for enacting States, all the relevant registry-related provisions are collected in a set of rules presented after article 28 of the Model Law and called the “Model Registry Provisions”.¹⁷ If the Model Registry Provisions are enacted in a separate law or other legal instrument, the Model Registry Provisions and the new secured transactions law should enter into force at the same time (for the need for the Registry to be fully operational before the new law enters into force, see para. 547 below).

145. The Model Registry Provisions have been drafted to accommodate flexibility in registry design. That said, the Registry should be electronic in the sense of permitting information in registered notices to be stored in electronic form in a single database (see Secured Transactions Guide, rec. 54 (j)(i), and chap. IV, paras. 38-41 and 43). An electronic registry database is the most efficient and practical means to implement the recommendation of the Secured Transactions

¹⁷ A reference to an article in this chapter is a reference to an article of the Model Registry Provisions, unless otherwise indicated.

Guide that the registry record should be centralized and consolidated (see rec. 54 (e), and chap. IV, paras. 21-24).

146. Access to registry services should also be electronic in the sense of permitting users to submit notices and search requests directly over the Internet or via networking systems (see Secured Transactions Guide, rec. 54 (j)(ii), and chap. IV, paras. 23-26 and 43). This approach eliminates the risk of registry staff error in entering the information contained in a paper notice into the registry record, facilitates speedier and more efficient access to registry services by users, and greatly reduces the operational costs of the Registry, translating into lower fees for registry users (for a discussion of these advantages and guidance on implementation, see Registry Guide, paras. 82-89).

147. The scope of application of the Model Law and, therefore, the scope of the notices of rights that are registrable in the Registry is limited to consensual security rights and outright transfers of receivables (see art. 1, paras. 1 and 2, and art. 2, subpara. (kk), and paras. 22, 23 and 68 above). While the Model Law does not include a provision on this matter, some States also provide for the registration of notices of rights created by the operation of other law in favour of specified classes of creditors (e.g. the State for tax claims and employees for employment benefits; see Registry Guide, paras. 46 and 51). If the enacting State follows this approach, it will need to ensure that the design of the Registry accommodates such registrations (and to specify the priority effect of registration in its law; see arts. 36 and 37 of the Model Law; see also Secured Transactions Guide, chap. V, para. 90, and Registry Guide, para. 51).

148. In addition, some States provide for the registration of notices of judgments obtained by a creditor of a grantor and treat registration as generally giving priority to the judgment creditor over consensual security rights that are subsequently made effective against third parties by registration. If the enacting State adopts this approach, it will need to ensure that the design of the Registry accommodates such registrations (and to make the appropriate adjustments to its general creditor-debtor law and its version of the Model Law; see art. 37 of the Model Law, and paras. 317-319 below; see also Registry Guide, para. 40).

149. Some States also provide for the registration of notices of the ownership rights of consignors and lessors under commercial consignments of inventory and long-term operating leases of tangible assets. Even though these arrangements do not function to secure an obligation, bringing them within the registration regime is intended to ensure that the consignor's or lessor's right is publicized to third parties who deal with the consigned or leased tangible assets in the hands of the consignee or lessee. If this approach is adopted, the enacting State will similarly need to ensure that the design of the Registry can accommodate such registrations

(and specify the priority effect of registration in its law; see Secured Transactions Guide, Introduction, para. 26, and Registry Guide, paras. 50 and 78).

Model Registry Provisions

Section A. General rules

Article 1. Definitions and rules of interpretation

150. Article 1 of the Model Registry Provisions contains definitions of key terms used in the Model Registry Provisions. These terms are derived from the Registry Guide (see Registry Guide, paras. 8 and 9). If the enacting State incorporates the Model Registry Provisions in its enactment of the Model Law, these definitions should be included in the provision implementing article 2 of the Model Law (except for the definition of the term “registry” which is also included in art. 2, subpara. (ee); see footnote 9 of the Model Law). In general, the definitions are self-explanatory. Where elaboration is needed, it is provided in the commentary on the relevant articles below.

Article 2. Grantor’s authorization for registration

151. Article 2 of the Model Registry Provisions is inspired by recommendations 71 of the Secured Transactions Guide (see chap. IV, para. 106) and 7(b), of the Registry Guide (see para. 101). Paragraph 1 provides that the registration of an initial notice is ineffective unless authorized by the grantor in writing (the rule is formulated in the negative, as the effectiveness of a registration is also subject to other requirements). If the grantor’s authorization covers a narrower range of encumbered assets than that described in the registered notice, the registration would be effective only with respect to the assets for which registration was authorized by the grantor. To ensure that this rule does not interfere with the efficiency of the registration process, paragraph 6 confirms that the Registry is not entitled to require evidence of the existence of the grantor’s authorization.

152. Paragraphs 4 and 5 confirm that: (a) the grantor’s authorization need not be obtained before registration; and (b) the conclusion of a written security agreement automatically constitutes authorization of a registration that covers an asset encumbered under that security agreement without the need to include an express authorization clause. Thus, the post-registration conclusion of a security agreement will constitute retrospective “ratification” of an initially unauthorized registration to the extent of the assets covered by the security agreement. If the security

agreement covers a narrower range of encumbered assets than those described in the registered notice, the registration would be authorized only with respect to the assets covered by the security agreement.

153. Paragraph 2 requires the grantor's authorization for the registration of an amendment notice that adds encumbered assets to those described in the prior registered notice. There is no need to register an amendment notice (and thus no need to obtain the authorization of the grantor) with respect to "additional assets" that are proceeds of encumbered assets described in a registered notice if the proceeds are: (a) of a type that falls within the existing description of encumbered assets in the registered notice (for example, the notice describes the encumbered assets as "all tangible assets" of the grantor and the grantor disposes of one type of tangible asset in exchange for another; see Secured Transactions Guide, rec. 39); or (b) "cash proceeds", that is, money, receivables, negotiable instruments or funds credited to a bank account (see art. 19, 1, of the Model Law, and para. 126 above).

154. Under the bracketed language in paragraph 2, the grantor's written authorization must also be obtained for the registration of an amendment notice to increase the maximum amount set out in a registered notice for which the security right to which the registration relates may be enforced. This provision is only needed in systems that require this information to be set out in the security agreement and in the registered notice (see art. 8, subpara. (e), of the Model Registry Provisions and, para. 175 below, as well as art. 6, para. 3 (d), of the Model Law, and para. 89 above).

155. Where an amendment notice seeks to add a new grantor, paragraph 3 requires the new grantor's authorization to be obtained. The existing grantor's authorization is not required for the registration of an amendment notice to disclose a post-registration change in the identifier of the grantor for the purposes of article 25; nor is the authorization of a buyer of an encumbered asset required to register an amendment notice adding the buyer as a new grantor in enacting States that decide to adopt option A or B of article 26.

156. If the grantor did not authorize the registration of a notice, or only authorized the registration of a notice covering a narrower range of encumbered assets than that described in the notice, or has withdrawn an initial authorization, article 20 provides a procedure by which the grantor can compel the secured creditor to register a cancellation notice or an amendment notice, as appropriate.

157. Registration of an amendment notice that adds encumbered assets, increases the maximum amount or adds a new grantor takes effect only from the time of the registration of the amendment notice regardless of whether authorization was obtained before or after its registration (see art. 13, para. 1, and para. 191 below).

Article 3. One notice sufficient for multiple security rights

158. Article 3 of the Model Registry Provisions is based on recommendations 68 of the Secured Transactions Guide (see chap. IV, para. 101) and 14 of the Registry Guide (see paras. 125 and 126). It confirms that a single registered notice is sufficient to achieve the third-party effectiveness of security rights arising under one or more security agreements between the grantor and the secured creditor. It should be emphasized that this rule applies only to the extent that the description of the encumbered assets in the registered notice includes the assets encumbered by the multiple security agreements (see Registry Guide, para. 126).

159. For example, if the initial security agreement between the parties covers only the grantor's tangible assets and the registered notice describes the encumbered assets as "all the grantor's tangible assets", a new initial notice (or an amendment to the existing notice) would have to be registered for a security right in the grantor's intangible assets under a subsequent security agreement to be effective against third parties, and that notice would take effect only from the time of its registration (see arts. 13, para. 1, and para. 191 below, as well as 29 of the Model Law, and paras. 285-294 below). On the other hand, if the registered notice describes the encumbered assets as "all of the grantor's movable assets", the registration of that single notice would be sufficient under the rule in this article to achieve the third-party effectiveness of the security rights created under both the initial and subsequent security agreements, and their priority would date from the time of the initial registration.

Article 4. Advance registration

160. Article 4 of the Model Registry Provisions is based on recommendations 67 of the Secured Transactions Guide (see chap. IV, paras. 98-101) and 13 of the Registry Guide (see paras. 122-124). It confirms that a notice may be registered before the creation of a security right to which the notice relates. This enables a security right under a security agreement covering future assets of the grantor to be made effective against third parties by a registration before the assets are actually acquired by the grantor and the security right comes into existence (see art. 6, para. 2, and art. 2, subpara. (n), of the Model Law).

161. Article 4 of the Model Registry Provisions also confirms that a registration may be made before the conclusion of any security agreement between the parties to which the notice relates. Pre-agreement registration is compatible with the registration process since, as already noted, (see para. 151 above), the underlying security agreement does not have to be submitted to the Registry to effect the registration of a notice. Advance registration is useful because it enables a secured

creditor to establish its priority ranking against competing secured creditors under the general first-to-register priority rule in article 29 of the Model Law even before its security agreement with the grantor is formally concluded. It should be emphasized, however, that advance registration does not make the security right to which it relates effective against other categories of competing claimants, if they acquire rights in the encumbered assets before the security agreement is actually entered into and the other requirements for creation of the security right to which the notice relates are satisfied (see, notably, arts. 34, 36 and 37 of the Model Law, and paras. 303-311 and 313-319 below).

162. Advance registration may be prejudicial to the grantor identified in a registered notice if a security agreement is never concluded or covers a narrower range of assets than those described in the registered notice. To protect the grantor in this scenario, article 20 provides a procedure under which the grantor may obtain the compulsory amendment or cancellation of the registered notice, as appropriate.

Section B. Access to registry services

Article 5. Conditions for access to registry services

163. Article 5 of the Model Registry Provisions is generally based on recommendations 54, subparagraph *(c)*, *(f)* and *(g)*, and 55 *(b)*, of the Secured Transactions Guide (see chap. IV, paras. 25-228) and 4, 6 and 9 of the Registry Guide (see paras. 95-97 and 103-105).

164. Paragraphs 1 and 3 confirm that the Registry must be public in the sense that any person is entitled to register a notice or search the registry record provided that the registrant or searcher submits the prescribed form of notice or search request and pays or makes any required arrangements to pay the prescribed fees, if any (as to the latter, see art. 33 of the Model Registry Provisions, and paras. 277-284 below).

165. Under paragraph 1 *(b)*, a registrant, as opposed to a searcher, must additionally identify itself to the Registry in the prescribed manner. This additional requirement is aimed at assisting the person identified in a registered notice as the grantor to determine the identity of the registrant in the event that the grantor did not authorize the registration (see Registry Guide, para. 96). This consideration must be balanced against the need to ensure efficiency and speed in the registration process. Accordingly, the evidence of identity required of a registrant should be that which is generally accepted as sufficient in day-to-day commercial transactions in the enacting State (for example, an identity card, driver's licence or other state-issued official document) provided it includes the registrant's contact details.

166. If access to registry services is refused, paragraph 4 requires the Registry to communicate the specific reason (for example, the registrant failed to use the prescribed form or to pay the prescribed fee) “without delay”. The concrete meaning of the words “without delay” depends on the mode by which the notice or search request is submitted to the Registry. If the system is designed to enable users to submit notices and search requests through electronic means of communication directly to the Registry, the system should be programmed to automatically communicate the reason during the registration or search process and display the reason on the registrant’s or searcher’s screen. If the system also permits notices and search requests to be submitted in paper form, the registry staff will need a reasonable time period to verify compliance with the conditions of access and prepare and communicate a response.

167. To facilitate efficient and secure access to registry services, the Registry should be organized to accept payments made electronically in a manner that ensures the confidentiality of the user’s financial information (see Registry Guide, para. 138). Efficient access by frequent users (such as financial institutions, automobile dealers or other suppliers of goods on credit, lawyers and other intermediaries) should be facilitated by entitling them to set up an account that enables them to deposit funds to pay for their ongoing requests for services.

168. To limit the risk of registration of an amendment or cancellation notice that is not authorized by the person identified in the initial notice as the secured creditor, paragraph 2 requires persons who submit an amendment or cancellation notice for registration to satisfy the secure access requirements specified by the enacting State. For example, the enacting State may require registrants to set up a password-protected account when submitting an initial notice and to submit all amendment and cancellation notices through that account. Alternatively, the system might be designed to assign a unique user code to registrants automatically upon registration of an initial notice, with that code then being required to be entered on all amendment and cancellation notices submitted for registration (with respect to the effectiveness of the registration of unauthorized amendment or cancellation notices, see art. 21).

Article 6. Rejection of the registration of a notice or a search request

169. Article 6 of the Model Registry Provisions reflects the principles in recommendations 8 and 10 of the Registry Guide (see paras. 97-99 and 106). Paragraph 1 obligates the Registry to reject the registration of a notice if no information or illegible information has been entered in any of the mandatory designated fields in the notice. As all mandatory fields must be completed for a registered notice to

be effective, this provision ensures that submitted notices that are self-evidently ineffective are never entered into the registry record. For example, article 8, paragraph (c), requires an initial notice to include a description of the encumbered assets. If no information or illegible information is entered in the field reserved for setting out the description, the registration will be rejected. On the other hand, the registration will be accepted if legible information is set out in the field designated for entering a description, even if the information that is entered is incorrect or incomplete, for example, the registrant mistakenly entered the address of the grantor in the field designated for entering a description of the encumbered assets.

170. Paragraph 2 obligates the Registry to reject a search request if no information or illegible information is entered in one of the designated fields for entering a search criterion. Since searchers are entitled to search by either the identifier of the grantor or the registration number assigned to the initial notice (see art. 22), it is sufficient if legible information is entered into at least one of the search criterion fields.

171. To avoid any arbitrary decisions on the part of the Registry, paragraph 3 confirms that the Registry may not reject the registration of a notice or search request where the registrant or searcher satisfies the access conditions set out in paragraphs 1 and 2.

172. Paragraph 4 requires the Registry to provide the reason for rejecting the registration of a notice or a search request without delay. As already noted (see para. 166 above), the system should be programmed to automatically communicate the reason during the registration or search process and to display the reason on the registrant's or searcher's screen. If the system also permits notices and search requests to be submitted in paper form, the registry staff will need to be given reasonable time to verify compliance, and to prepare and communicate a response.

Article 7. Information about the registrant's identity and scrutiny of the form or contents of a notice by the Registry

173. Article 7 of the Model Registry Provisions is based on recommendations 54 (d), and 55 (b), of the Secured Transactions Guide (see chap. IV, paras. 15-17 and 48) and 7 of the Registry Guide (see paras. 100 and 102). Paragraph 1 obligates the Registry to maintain the identity information submitted by registrants in compliance with article 5, paragraph 1(b), and to provide that information upon request to the person identified in the registered notice as the grantor. While this information does not form part of the public or archived registry record, it nonetheless must be preserved by the Registry in a manner that makes it possible for its retrieval in association with the registered notice to which it relates. This is consistent with the

rationale for obtaining and preserving this information, which is to assist the grantor in identifying the registrant in cases where the registration of the notice was not authorized by the grantor (see para. 165 above). In order to ensure that this objective is balanced against the need to facilitate the efficiency of the registration process, paragraph 2 provides that the Registry is not permitted to require further verification of the identity information provided by a registrant under article 5, paragraph 1(b). With the same objective in mind, paragraph 3 prohibits the Registry from scrutinizing the form or content of notices and search requests submitted to it except to the extent needed to give effect to articles 5 and 6.

Section C. Registration of a notice

Article 8. Information required in an initial notice

174. Article 8 of the Model Registry Provisions is based on recommendations 57 of the Secured Transactions Guide (see chap. IV, para. 65) and 23 of the Registry Guide (see paras. 157-160). It sets out the items of information required to be entered in the appropriate designated fields in an initial notice. The items specified in subparagraphs (a), (b) and (c) are the subject of articles 9, 10 and 11 of the Model Registry Provisions (see paras. 177-188 below), and the reader is generally referred to the commentary on those articles. It should be noted that where a notice relates to more than one grantor or secured creditor, the required information should be entered in separate designated fields for each grantor or secured creditor.

175. Subject to its privacy laws, the enacting State may decide to require “additional information” (such as the birth date of the grantor or an identification number issued by the enacting State) to be entered to assist in uniquely identifying a grantor where there is a risk that many persons may have the same name (see bracketed text in art. 8, subpara. (a)). This is more likely to pose a concern for a grantor that is a natural person as States usually impose constraints on new business entities using the same name as an existing business entity. If this approach is adopted, the form of notice prescribed by the enacting State should provide a separate designated field for entering the “additional information”. The enacting State should also specify the nature of the additional information to be provided and make its inclusion mandatory in the sense that it must be entered in the relevant field for a notice to be registered. If the required additional information is an identification number issued by the enacting State, it will also be necessary to address cases in which the grantor is not a citizen or resident of the enacting State, or for any other reason has not been issued an identification number. Subject to privacy considerations, the enacting State might, for example, provide that the number of the grantor’s foreign passport or some other foreign official document

is a sufficient substitute (on all these points, see Registry Guide, rec. 23 (a)(i), and paras. 167-169, 171, 181-183, 226, as well as annex II, Examples of registry forms).

176. Subparagraph (d) appears within square brackets, as an indication of the duration of registration on an initial notice is required only if the enacting State adopts options B or C of article 14 of the Model Registry Provisions (see paras. 195-197 below; see also Registry Guide, paras. 199-204). Subparagraph (e) also appears within square brackets, as an indication of the maximum amount for which the security right may be enforced is required only if the enacting State implements the approach set out in article 6, paragraph 3 (d), of the Model Law, which also appears within square brackets (see para. 89 above).

Article 9. Grantor identifier

177. Article 9 of the Model Registry Provisions is based on recommendations 59 and 60 of the Secured Transactions Guide (see chap. IV, paras. 68-74), as well as recommendations 24 and 25 of the Registry Guide (see paras. 161-183). It provides that the identifier of the grantor is the name of the grantor. It then sets out separate rules for determining the name of the grantor depending on whether the grantor is a natural person or a legal person.

178. If the grantor is a natural person, paragraph 1 provides that the grantor's name is the name that appears in the official document specified by the enacting State as the authoritative source. As not all grantors will possess a common official document (e.g., an identity card or driver's licence), the enacting State will need to specify alternative official documents as authoritative sources and specify the hierarchy of authoritativeness among them (for examples of possible approaches, see Registry Guide, paras. 163-168).

179. As already noted (see para. 175 above), the enacting State may require the entry of a State-issued identity or other official number as additional information to assist in uniquely identifying a grantor. Instead of the name, the enacting State may decide to make this number a grantor identifier. Since the grantor identifier is the criterion used to search the registry record, this approach is only feasible if there is a reliable record or other objective source that searchers can consult to determine a person's official number. If this approach is adopted, it will also be necessary for the enacting State to address cases in which the grantor is not a citizen or resident of the enacting State, or for any other reason has not been issued an identification number. The enacting State might, for example, provide that the number in some other foreign official document is a sufficient substitute provided again that the relevant number is accessible to searchers. Otherwise, the name of the foreign grantor will have to be used as the grantor identifier (see Registry Guide, paras. 168 and 169).

180. Paragraph 2 requires the enacting State to indicate which components of the name of a grantor who is a natural person must be entered in the notice. The enacting State will need to specify, for example, whether only the given and family name of the grantor is required or whether a middle name or initial, if any, must also be included. It will also need to address the scenario where the grantor's name consists of a single word, for example, by providing that that word should be entered in the family name field and by ensuring that the registry system is designed so as not to reject notices that have no information entered in the other name fields (see Registry Guide, para. 165).

181. Paragraph 3 requires the enacting State to address how the grantor's name is to be determined where the grantor's name has legally changed under applicable law after the issuance of the official document designated in paragraph 1 as the authoritative source of the grantor's name (for example, as a result of an application for a name change under change of name legislation; see Registry Guide, para. 164 (*f*)).

182. Paragraph 4 provides that where the grantor is a legal person the name of the grantor is the name that appears in the relevant document, law or decree to be specified by the enacting State constituting the legal person (see Registry Guide, paras. 170-173).

183. Paragraph 5, which appears in square brackets, provides for the possibility that an enacting State may wish to require additional information pertaining to the grantor's status to be entered in a notice in special cases, such as where the grantor is subject to insolvency proceedings (see Registry Guide, paras. 174-179). If the enacting State adopts this approach, it must ensure that the prescribed form of notice contains a field to enter the relevant status information.

Article 10. Secured creditor identifier

184. Article 10 of the Model Registry Provisions is based on recommendations 57 (*a*) of the Secured Transactions Guide (see chap. IV, para. 81) and 27 of the Registry Guide (see paras. 184-189). It largely replicates the rules in article 9 for determining the identifier of the grantor. Unlike under article 9 of the Model Registry Provisions (read together with art. 8, subpara. (*a*), and para. 174 above), however, under article 10 (read together with art. 8, subpara. (*b*), and para. 174 above), the registrant may enter the name of a representative of the secured creditor (e.g. a law firm or other service provider or an agent of a syndicate of lenders). This approach is intended to protect the privacy of the actual secured creditor and facilitate the efficiency of arrangements such as syndicated loans where there are multiple secured creditors who may change over time. This approach does not have

a negative impact on the grantor, who would typically know the identity of the actual secured creditor from their dealings, or third parties, as long as the representative is authorized to act on behalf of the actual secured creditor (see Registry Guide, paras. 186 and 187). It should also be noted that, as the security right is created by an off-record security agreement, the entry of the name of a representative as the secured creditor on a registered notice does not make the representative the actual secured creditor.

Article 11. Description of encumbered assets

185. Article 11 of the Model Registry Provisions is based on recommendations 63 of the Secured Transactions Guide (see chap. IV, paras. 82-86) and 28 of the Registry Guide (see paras. 190-192). The test for the adequacy of a description of the encumbered assets in a registered notice in paragraph 1 parallels the test for the adequacy of a description of the encumbered assets in a security agreement (see art. 9 of the Model Law, and paras. 95 and 96 above). That said, the description in a registered notice need not be identical to the description in any related security agreement so long as it reasonably allows identification of the relevant encumbered assets in accordance with the test in paragraph 1.

186. Paragraph 2 confirms that a description in a registered notice that refers to all of the grantor's movable assets or to all of the grantor's assets within a specified generic category (for example, all receivables owing to the grantor) satisfies the test in paragraph 1 that the description reasonably allow identification of the encumbered assets. It follows that a generic description will be sufficient even if any related security agreement only covers a specific asset within that broad generic category (for example, the description in the registered notice refers to all "tangible assets of the grantor", whereas the security agreement only covers a specific tangible asset). However, the effectiveness of the registration in this scenario is dependent upon the authorization of the grantor pursuant to article 2; if the grantor only authorized a registration covering a specific asset, the registration will only be effective with respect to that asset. Moreover, the grantor is entitled, pursuant to article 20, paragraph 1, to compel the secured creditor to register an amendment notice that narrows the description of the assets in the registered notice to correspond to the encumbered assets actually covered by the security agreement unless the grantor separately authorized the secured creditor to register a broader description (see para. 150 above) and has not withdrawn that authorization.

187. The secured transactions laws of some States adopt special rules for describing specified classes of high-value assets that have a significant resale market alpha-numerically where they have a unique serial number or equivalent unique alphanumeric identifier. In States that adopt this approach, entry of the serial number in its own designated field is required in the sense of being necessary to

preserve the priority of the security right as against specified classes of third parties that acquire rights in the asset. Enacting States that are interested in adopting this approach will need to revise the priority rules of the Model Law to specify the priority consequences of a failure of entering the relevant serial number and to revise the registry design and the registry-related provisions to accommodate serial-number-based registration and searching (for the rationale for, and the advantages and disadvantages of this, approach, see Registry Guide, paras. 131-134; for the consequences of a failure of entering the serial number or an error in entering the serial number, see Registry Guide, paras. 193 and 213; and for the registry design and registry provisions needed to implement this approach, see Registry Guide, para. 266). It should be noted that even in legal systems that do not adopt this approach, a registrant may choose to include the serial number in the description it enters in the notice as a convenient method of describing the encumbered asset in a manner that reasonably allows its identification (see Registry Guide, paras. 194 and 212). On the other hand, using only the specific serial number as the description may be risky since any error would render the description insufficient whereas a more generic description (e.g. a description of the grantor's automobile by make and model, or simply as "automobile") may reduce the risk of error.

188. There is no need to register an initial or amendment notice to describe proceeds of an encumbered asset in the form of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account (see art. 19, para. 1, of the Model Law). If the proceeds take any other form and are not already covered by the description of the encumbered assets in a registered notice, the secured creditor must register a notice to add a description of the proceeds or otherwise make its security right in the proceeds effective against third parties within a short period of time to be specified by the enacting State (e.g. 20-25 days) after they arise in order to preserve the third-party effectiveness and priority of its security right in the proceeds (see arts. 19, para. 2, and 32 of the Model Law). The registration of a notice is necessary because otherwise a third-party searcher would not be alerted to the potential existence of a security right in the assets constituting the proceeds (see Registry Guide, para. 197).

Article 12. Language of information in a notice

189. Article 12 of the Model Registry Provisions is based on recommendation 22 of the Registry Guide (see paras. 153-156; the Secured Transactions Guide includes a discussion of this matter in chap. IV, paras. 44-46, but does not include a recommendation). Paragraph 1 requires the information contained in a notice to be expressed in the language or languages to be specified by the enacting State except for the names and addresses of the grantor and the secured creditor or its representative. Typically, the enacting State will require registrants to use its officially

recognized language or languages. As the other items of information, such as the period of effectiveness of the registration, required to be entered in a notice can be expressed by numbers, registrants will only need to translate the description of the encumbered assets. Where the description of the encumbered assets is not expressed in the required language, the registration of the notice would be ineffective as seriously misleading (see art. 24, para. 4, and para. 239 below).

190. Paragraph 2 requires all information in a notice to be in the character set prescribed and publicized by the Registry. Otherwise, the notice will be rejected as illegible under article 6, paragraph 1 (*a*) (see para. 169 above; for the same rule with respect to search requests, see art. 6, para. 2, and para. 170 above). Accordingly, while the names and addresses of the grantor and secured creditor or its representative need not be translated under paragraph 1 if they are expressed in a language that uses a different character set than that prescribed by the Registry, they will need to be adjusted or transliterated to conform to the prescribed character set (see Registry Guide, para. 155).

Article 13. Time of effectiveness of the registration of a notice

191. Article 13 of the Model Registry Provisions is based on recommendations 70 of the Secured Transactions Guide (see paras. 102-105) and 11 of the Registry Guide (see paras. 107-112). Paragraph 1 provides that the registration of an initial or amendment notice is effective only once the information in the notice is entered into the public registry record so that it is accessible to searchers (see the definition of the term “registry record” in art. 1, subpara. (*l*)). Paragraph 3 requires the Registry to record that date and time and to make this information available to searchers.

192. In view of the importance of the timing and order of registration to the third-party effectiveness and priority of a security right, paragraph 2 requires the Registry to enter the information into the registry record “without delay” and in the order in which it was submitted. The meaning of the words “without delay” depends in practice on the design of the registry system. If the system enables users to submit information in a notice directly to the Registry through electronic means of communication without the intervention of registry staff, those words will typically mean “with little or no delay” since in this case the information in the notice submitted to the Registry will almost instantaneously be entered into the registry record. However, in systems that permit or require the use of paper notice forms, there will inevitably be some time lag since the registry staff must enter the information on the paper notice form into the registry record. Thus, in this case, the words “without delay” will mean “as soon as practically feasible”.

193. Paragraph 4 deals with the time of effectiveness of the registration of a cancellation notice. Option A provides that the registration of a cancellation notice is effective once the information in the registered notices to which the cancellation notice relates is no longer publicly searchable. Option A should be adopted by enacting States that adopt option A or B of article 21 of the Model Registry Provisions (see paras. 221-223 below), since these options require the Registry to remove information in a registered notice from the public registry record and archive it upon registration of a cancellation notice pursuant to option A of article 30 of the Model Registry Provisions (see para. 263 below). Option B provides that the registration of a cancellation notice becomes effective once the information in the cancellation notice is entered into the registry record so as to be accessible to searchers. Option B should be adopted by enacting States that adopt option C or D of article 21 since these options require the Registry to retain the information in all registered notices, including cancellation notices, on the public registry record until the effectiveness of the registration lapses pursuant to option B of article 30.

194. Option A and option B of paragraph 5 require the Registry to record the date and time of effectiveness of the registration of a cancellation notice as determined by option A and option B of paragraph 4 respectively. Accordingly, enacting States that adopt option A of paragraph 4 should adopt option A of paragraph 5, while enacting States that adopt option B of paragraph 4 should adopt option B of paragraph 5.

Article 14. Period of effectiveness of the registration of a notice

195. Article 14 of the Model Registry Provisions is based on recommendations 69 of the Secured Transactions Guide (see chap. IV, paras. 87-91) and 12 of the Registry Guide (see paras. 113-121, 240 and 241). It offers enacting States a choice of three different approaches to the determination of the period of effectiveness (or duration) of the registration of a notice. If option A is adopted, an initial notice (and any associated amendment notice) is effective for the period specified by the enacting State (e.g. five years). If option B is adopted, registrants are permitted to specify the desired period of effectiveness. If option C is adopted, registrants are likewise permitted to determine the period of effectiveness but only up to the maximum number of years specified by the enacting State.

196. Paragraphs 2 and 3 permit the period of effectiveness of a notice to be extended and re-extended before its expiry by the registration of an amendment notice. Paragraph 2 of option B permits the period of effectiveness to be extended at any time before its expiry, whereas paragraph 2 of options A and C permit an extension to be made only during the period specified by the enacting State (e.g.

four to six months) before expiry of the current period of effectiveness. The reason for this difference is to prevent a registrant from undermining the maximum period of effectiveness specified by the enacting State under options B and C by extending the period of effectiveness of a registration at an earlier point. Under paragraph 4 of option A, the duration of the registration would be extended for the period specified by the enacting State as the period of effectiveness of an initial notice. Under paragraph 4 of option B or option C, the registrant is permitted to determine the duration of the further period of effectiveness, but only up to the maximum number of years prescribed by the enacting State in the case of option C.

197. If option B or option C is adopted, the period of effectiveness of the registration must be included in a notice (see art. 8, subpara. (d)). States that adopt either of these options will also need to prescribe how registrants must enter the desired period of effectiveness in the notice. The notice form might be designed to enable registrants to simply enter the desired number of whole years or to permit registrants to enter or select the specific day, month and year on which the registration is to expire.

Article 15. Obligation to send a copy of a registered notice

198. Article 15 of the Model Registry Provisions is based on recommendations 55 subparagraphs (c), (d) and (e) of the Secured Transactions Guide (see chap. IV, paras. 49-53) and 18 of the Registry Guide (see paras. 145-149). Paragraph 1 obligates the Registry to send a copy of the information in a registered notice to the person identified in the notice as the secured creditor without delay after the registration becomes effective. To avoid delay, the registry system should be designed to automatically generate and transmit the copy electronically to the secured creditor (see Registry Guide, para. 146). This is intended to enable the secured creditor to verify the correctness of the information in the registered notice and to alert it to the erroneous or unauthorized registration of an amendment or cancellation notice (for the effectiveness of the registration of amendment or cancellation notices not authorized by the secured creditor, see art. 21 of the Model Registry Provisions, and paras. 219-227 below; see also Registry Guide, paras. 249-259; for the liability of the Registry for failure to send a copy of the information in a registered notice, see art. 32 of the Model Registry Provisions, and paras. 270-275 below).

199. Paragraph 2 obligates the secured creditor to forward a copy of the information it receives from the Registry pursuant to paragraph 1 to the person identified in the notice as the grantor. The purpose of this requirement is to enable that

person to take the steps necessary to correct the registry record if the registration was wholly or partially unauthorized by that person (see art. 20). The secured creditor must comply with this obligation before the expiry of the period specified by the enacting State after it receives a copy of the registered notice (e.g. 14 days). The copy must be sent to the grantor at its address set forth in the registered notice or at the grantor's new address if the secured creditor knows that the grantor has changed its address and knows or could reasonably discover that address. Placing the burden of forwarding a copy of the registered notice to the grantor on the secured creditor rather than on the Registry is the result of a cost-benefit analysis and is intended to avoid creating an additional burden for the Registry which could negatively affect its efficiency (see Registry Guide, para. 149).

200. Paragraph 3 provides that non-compliance by the secured creditor with its obligation under paragraph 2 does not by itself affect the effectiveness of the registration. Paragraph 4 limits the secured creditor's liability for non-compliance to a nominal amount (to be specified by the enacting State) and any actual loss or damage caused by its non-compliance. Paragraph 4 leaves to the relevant law of the enacting State related matters, such as the standard of liability and the way in which the actual loss or damage is to be measured.

Section D. Registration of an amendment or cancellation notice

Article 16. Right to register an amendment or cancellation notice

201. Article 16 of the Model Registry Provisions is based on recommendations 73 of the Secured Transactions Guide (see chap. IV, paras. 110-116) and 19 (a), of the Registry Guide (see paras. 150 and 225-244). Paragraph 1 gives the person identified in an initial notice as the secured creditor the right to register a related amendment or cancellation notice at any time. In order to limit the risk of the registration of notices not authorized by that person, the registrant must satisfy the secure access requirements that were prescribed under article 5, paragraph 2, of the Model Registry Provisions (see para. 168 above). To ensure that the person identified in the registered notice as the secured creditor (or another person acting on its behalf) may register subsequent amendment and cancellation notices, the secure access details should be communicated to that person at the time of registration of the initial notice or as soon as possible thereafter.

202. Paragraph 2 provides that, after an amendment notice changing the person identified in a registered notice as the secured creditor has been registered, the registry system should be designed so that only the current secured creditor of

record may register an amendment or cancellation notice. Where the change in the secured creditor identifier results from an assignment of the secured obligation, the registry system should be designed to assign new secure access details to the new secured creditor to prevent the previous secured creditor from registering an amendment or cancellation notice (see para. 155 above). Where the change in the secured creditor identifier instead results from a change in the name of the secured creditor, no such precautionary step is needed since the secured creditor is still the same person.

Article 17. Information required in an amendment notice

203. Article 17 of the Model Registry Provisions is based on recommendation 30 of the Registry Guide (see paras. 221-224; the Secured Transactions Guide does not contain an equivalent recommendation). Paragraph 1 provides that an amendment notice must contain in the designated field the registration number assigned by the Registry to the initial notice to which the amendment relates (see art. 28, para. 1, and para. 243 below). The reason for this requirement is to ensure that the amendment notice will be associated in the registry record with the initial notice so as to be retrieved and included in a search result (see the definition of the term “registration number” in art. 1, subpara. (j), and para. 137 above; for the registration number as a search criterion, see art. 22, subpara. (b), and para. 217 below)).

204. Paragraph 1 (b) requires the amendment notice to set out the information to be “added or changed”. The term “change” includes the release of an encumbered asset or one of several grantors. Although this type of change amounts in effect to a cancellation of the registration as it relates to the relevant asset or grantor, it should be effected by registering an amendment notice and not a cancellation notice. A cancellation notice is to be used only when the purpose is to cancel the effectiveness of the registration of an initial notice and all related notices in their entirety (see the definitions of “amendment notice” and “cancellation notice” in art. 1, subparas. (b) and (c), of the Model Registry Provisions, and para. 150 above).

205. Paragraph 2 makes it clear that an amendment notice may relate to more than one item of information in a registered notice. This means that a registrant may register only one amendment notice even if it wishes, for example, to add both a description of new encumbered assets and a new grantor, or to add a new grantor and also change some information (e.g. an address) related to the grantor already covered by the registered notice. It follows that the registry system must be designed to enable a registrant to change any and all items of information in a registered notice using a single amendment notice (see Registry Guide, Annex II, Examples of registry forms, II. Amendment notice).

Article 18. Global amendment of secured creditor information

206. Article 18 of the Model Registry Provisions is based on recommendation 31 of the Registry Guide (see para. 242; the Secured Transactions Guide does not contain an equivalent recommendation). It addresses the scenario where there is a change in the identifier or address, or both, of the person identified in multiple registered notices as the secured creditor as a result, for example, of its relocation, its merger with another company or the assignment of all its secured obligations to a new secured creditor. Its purpose is to make it possible for the secured creditor of record (option A) or the Registry on the application of that person (option B) to amend the relevant information in all the registered notices by the registration of a single global amendment notice.

207. To effect the amendment of secured creditor information in multiple notices through the registration of a single global amendment notice, the registry record must be organized in a manner that enables the retrieval of all registered notices in which a particular person is identified as the secured creditor. To avoid the risk of the registration of unauthorized global amendment notices, the Registry should institute procedures in addition to the secure access requirements prescribed under article 5, paragraph 2, to ensure that the person requesting or effecting a global amendment is in fact the secured creditor of record (see para. 155 above).

Article 19. Information required in a cancellation notice

208. Article 19 of the Model Registry Provisions is based on recommendation 32 of the Registry Guide (see paras. 243 and 244; the Secured Transactions Guide does not contain an equivalent recommendation). It requires a cancellation notice to contain in the designated field the registration number assigned by the Registry under article 28, paragraph 1, of the Model Registry Provisions to the initial notice to which the cancellation notice relates. The registration number is the only item of information required to be included in a cancellation notice (see Registry Guide, annex II, Examples of registry forms, III. Cancellation notice).

209. The inclusion of the registration number in a cancellation notice ensures that the cancellation notice extends to the information in all registered notices containing that number (see the definition of the term “registration number” in art. 1, subpara. (j)). To minimize the risk of the inadvertent registration of cancellation notices, the prescribed cancellation notice form should expressly indicate the effect of a cancellation (see Registry Guide, annex II, Examples of registry forms, III. Cancellation notice for States that select option A of art. 30 of the Model Registry Provisions; with respect to the effectiveness of a cancellation notice not authorized by the secured creditor, see paras. 219-227 below).

Article 20. Compulsory registration of an amendment or cancellation notice

210. Article 20 of the Model Registry Provisions is based on recommendations 72 of the Secured Transactions Guide (see chap. IV, paras. 107 and 108) and 33 of the Registry Guide (see paras. 260-263). It should be read in conjunction with article 2, which requires the person identified as the grantor in a registered notice to authorize its registration.

211. Paragraph 1 (*a*) obligates the secured creditor to register an amendment notice deleting encumbered assets from the description in the registered notice if the grantor identified in the notice did not authorize the registration of a notice in relation to those assets and has informed the secured creditor that it will not do so in the future. For example, the secured creditor may have registered an initial notice covering “all assets” of the grantor but the security agreement between the parties covers only a specific tangible asset and the grantor informs the secured creditor that it does not contemplate entering into any further security agreement. Even if the grantor separately authorized the registration of a notice covering “all assets”, paragraph 1 (*c*) obligates the secured creditor to amend the description in its registered notice if the grantor subsequently withdraws its authorization, provided that no security agreement covering those assets is concluded thereafter (since this would automatically constitute a new authorization under art. 2).

212. Paragraph 1 (*b*) addresses the scenario where the security agreement to which a registered notice relates is revised to release some of the initially encumbered assets from the security right. In this scenario, the secured creditor is obligated to register an amendment notice to delete the released assets from the description in the registered notice provided that the grantor did not authorize the registration of a notice covering the released assets otherwise than by entering into the initial security agreement. Even if the grantor executed a separate agreement authorizing the secured creditor to make the registration, paragraph 1 (*c*) obligates the secured creditor to register an amendment notice deleting the released assets if the grantor subsequently withdraws that authorization, provided that the parties have not entered into a new security agreement covering the released assets.

213. Enacting States that implement article 8, subparagraph (*e*), will need to adopt paragraph 2 which requires a secured creditor to register an amendment notice reducing the maximum amount specified in a registered notice if: (*a*) the grantor only authorized the registration of a notice in the reduced amount and the grantor has advised the secured creditor that it will not authorize registration of a notice in the higher amount; or (*b*) the security agreement to which the notice relates has been revised to reduce the maximum amount and the grantor has not otherwise authorized the registration of a notice in the higher amount.

214. Paragraphs 3 (a) and 3 (b) obligate the secured creditor to register a cancellation notice where the grantor identified in a registered notice either did not authorize the registration and has informed the secured creditor that it will not do so, or the grantor, having initially authorized the registration, later withdrew its authorization and the parties have not entered into a security agreement. Under paragraph 3 (c), a cancellation notice must also be registered if the obligation secured by the security right to which the registered notice relates has been extinguished. It should be noted that, under article 12 of the Model Law, a security right is extinguished upon full payment or other satisfaction of the secured obligation, provided that there is no commitment by the secured creditor to extend any further secured credit.

215. Paragraph 4 prohibits the secured creditor from charging any fee for complying with its obligations under paragraphs 1 (a), 1 (c), 2 (a), 3 (a) and 3 (b). These provisions require a secured creditor to amend or cancel a registration either because it was never authorized by the grantor or because the grantor's initial authorization was withdrawn owing to the failure of the parties to subsequently conclude a security agreement. In these circumstances, it is appropriate to impose the cost on the secured creditor.

216. To protect grantors against the risk of non-compliance by a secured creditor with its obligation under paragraphs 1, 2 and 3, paragraph 5 gives the grantor the right to send a formal written request to the secured creditor to register the appropriate amendment or cancellation notice. If the person identified as the secured creditor in the notice is not the actual secured creditor but its representative, the grantor should be entitled to send its request to the representative.

217. If the secured creditor does not comply with the grantor's request under paragraph 5 within the time period specified by the enacting State, paragraph 6 entitles the grantor to apply for an order compelling registration of the appropriate notice. In order to avoid unnecessary delays, it is suggested that the period specified be as short as possible (e.g. 14 days). This is in line with the rationale underlying the requirement in paragraph 6 for the enacting State to establish a summary judicial or administrative procedure for obtaining the order. The enacting State may decide to use an existing administrative or judicial summary procedure or it may decide to set up a new procedure administered, for example, by the Registrar or registry staff. As noted in the Registry Guide (see para. 262), while the process should be speedy and inexpensive, it should also incorporate appropriate safeguards to protect the secured creditor against an unwarranted demand by the grantor (for example, by requiring the relevant authority to notify the secured creditor of the grantor's application and give the secured creditor a reasonable opportunity to respond).

218. Once an order for registration has been issued pursuant to the procedure under paragraph 6, paragraph 7 requires the Registry to register the appropriate notice “upon receipt of a request with a copy of the relevant order” (if the enacting State decides under para. 6 to designate a court or other external body to administer the procedure) or “upon the issuance of the relevant order” (if the enacting State decides under para. 6 to vest the Registry with the authority to administer the procedure).

Article 21. Effectiveness of the registration of an amendment or cancellation notice not authorized by the secured creditor

219. Article 21 of the Model Registry Provisions addresses the effectiveness of the registration of an amendment or cancellation notice where the registration was not authorized by the secured creditor of record. While neither the Secured Transactions Guide nor the Registry Guide contains a recommendation on this matter, the Registry Guide discusses it in some detail (see paras. 249-259).

220. An unauthorized registration of an amendment or cancellation notice may occur as a result of fraud or error by a third party or even by a member of the registry staff (for corrections of errors by the Registry, see art. 31). The issue is whether and to what extent conclusive effect should nonetheless be given to an unauthorized registration for the purposes of determining the third-party effectiveness and priority of the related security right as against a competing claimant. Article 21 requires the enacting State to choose between four options. In making that choice, enacting States will need to decide whether the balance should favour reliability of the registry record for searchers including prospective secured creditors (options A and B), or protection of secured creditors who have registered a notice of their security rights against the risk of losing the third-party effectiveness or priority status of their security right (options C and D). It should be emphasized that, regardless of which option is adopted, the risk of the unauthorized registration of amendment or cancellation notices is greatly reduced by the requirement for the enacting State to prescribe secure access procedures for registering amendment and cancellation notices (see art. 5, para.2, and para.155 above).

221. Under option A, the registration of an amendment or cancellation notice is effective even if it was not authorized by the person identified as the secured creditor in the registered notice to which the amendment or cancellation notice relates.

222. Option B is a variation of option A. While recognizing the general effectiveness of an unauthorized amendment or cancellation notice, it preserves the priority of the security right to which the unauthorized registration relates as against the right

of a competing claimant over whom the security right covered by that registered notice had priority prior to the unauthorized registration of the amendment or cancellation notice. This option is predicated on the rationale that such a claimant generally could not have been prejudiced by relying on the unauthorized registration

223. If an enacting State decides to adopt option A or option B, it will need to implement option A of article 30, which obligates the Registry to remove information in a registered notice from the public registry record and archive it upon registration of a cancellation notice. Otherwise, the registered notice would remain on the record and thus potentially impair the grantor's ability to obtain new secured financing notwithstanding the registration of the cancellation notice. An enacting State that adopts option A or option B will also need to implement option A of article 13, paragraphs 4 and 5, providing that the registration of a cancellation notice is effective from the time when the information in the notice to which it relates is no longer accessible to searchers of the public record.

224. Option C is at the opposite end of the spectrum from option A. It provides that the registration of an amendment or cancellation notice is effective only if it was authorized by the secured creditor of record. Under this approach, a searcher will need to conduct off-record inquiries to verify whether the registration of an amendment or cancellation notice was in fact authorized by the secured creditor.

225. Option D is a variation of option C. It preserves the effectiveness of an unauthorized registration of an amendment or cancellation notice (and subordinates a security right affected by the unauthorized registration to the right of a competing claimant), if a competing claimant acquired its right in reliance on a search of the registry record made after the registration of the amendment or cancellation notice, and did not have knowledge that the registration was unauthorized when it acquired its right. This qualification differs from the qualification in option B above insofar as it requires the competing claimant to provide factual evidence that it searched and relied on the registry record prior to acquiring its right in order to prevail over the secured creditor whose registration was amended or cancelled without authority.

226. If an enacting State decides to adopt option C or option D, it will need to implement option B of article 30, which obligates the Registry to remove information in registered notices from the public registry record and archive it only upon the expiry of the period of effectiveness of the registration of the notice (see para. 251 below). Under option C or D, all amendment and cancellation notices need to remain in the public registry record for searchers to discover whom to contact to verify whether the amendment or cancellation was authorized. If all the relevant notices were instead removed from the public record upon registration of a cancellation notice, searchers would have no means of discovering from a search of the registry that a security right effective as against them may potentially still

exist. It will also need to implement option B of article 13, paragraphs 4 and 5, of the Model Registry Provisions, dealing with the time of effectiveness of the registration of a cancellation notice (see paras. 193 and 194 above).

227. Searchers may not necessarily appreciate that registered amendment and cancellation notices may not be legally effective. Accordingly, enacting States that implement options C or D may wish to include a note on search results advising searchers of the need to conduct off-record inquiries to verify whether the registration of an amendment or cancellation notice was authorized by the secured creditor of record.

Section E. Searches

Article 22. Search criteria

228. Article 22 of the Model Registry Provisions is based on recommendation 54 (*h*) of the Secured Transactions Guide (see chap. IV, paras. 31-36) and 34 of the Registry Guide (see paras. 264-265). It sets out the two criteria according to which any person may conduct a search of the public registry record.

229. Under subparagraph (*a*), the first and principal search criterion is the identifier of the grantor. The identifier of the grantor is its name, determined according to the rules set out in article 9. If an enacting State decides to require “additional information” to be entered to assist in uniquely identifying a grantor, this additional information does not constitute a part of the name search criterion nor is it an alternative search criterion (see art. 8, subpara. (*a*)). Rather it will simply appear as additional information in a search result. Accordingly, in States that adopt this approach, search request forms should be designed to require the entry of the additional information in a separate designated field and not in the field for entering the name of the grantor.

230. Under subparagraph (*b*), the registration number assigned to an initial notice in accordance with article 28, paragraph 1, constitutes an alternative search criterion. A search by registration number gives secured creditors an efficient means of identifying and retrieving a registered notice for the purposes of registering an amendment or cancellation notice. Searches by registration number generally will not be conducted by third parties as they typically will not know the relevant registration number. In those registry systems that establish accounts for users, it may not be necessary to provide for indexing and searching according to registration numbers as the history of registrations typically will be stored in each user’s account and be easily accessible to the account holder.

231. If the enacting State decides to introduce the serial number of specified types of tangible asset as a search criterion, it will need to list the serial number

as an additional search criterion in this article. It will also need to design the registry system so that registered notices can be searched and retrieved by serial number (see Registry Guide, para. 266, and para. 174 above).

232. To allow the registration of global amendment notices, as provided in article 18, the registry record must be organized to permit registered notices to be identified and retrieved by reference to the identifier of the relevant secured creditor. For public policy reasons relating to privacy and confidentiality, the name or other identifier of the secured creditor should not be an available criterion for searching by the general public (see Secured Transactions Guide, chap. IV, para. 81 and Registry Guide, para. 267).

Article 23. Search results

233. Article 23 of the Model Registry Provisions is based on recommendation 35 of the Registry Guide (see paras. 268-273; the Secured Transactions Guide does not contain an equivalent recommendation). Paragraph 1 sets out the required content of search results provided by the Registry in response to a search request. The search result must indicate the date and time when the search was performed.

234. With respect to the substantive content of the search result, paragraph 1 contemplates that an enacting State may adopt one of two options. Option A contemplates that the enacting State's registry system is designed to only retrieve notices that exactly match the identifier of the grantor entered by the searcher in its search request. Option B contemplates that the enacting State's registry system is designed to retrieve notices that closely match the identifier of the grantor entered by the searcher. Option B builds in a certain degree of forgiveness for registrant or searcher error in entering the identifier of the grantor. The extent of close matches disclosed in registry systems in States that adopt option B will depend on the specific close-match search programme or logic used by the Registry. The enacting State should not implement a search logic that could potentially result in a long list of close matches since this would make it too difficult for a searcher to determine which, if any, of the registered notices disclosed in the search result refer to the grantor that the searcher is inquiring about.

235. Option A should be read in conjunction with article 24, paragraph 1, which provides that an error by a registrant in entering the grantor identifier in a notice does not render the registration of the notice ineffective if the information in the notice would be retrieved by a search of the registry record using the grantor's correct identifier as the search criterion. Option B should be read in conjunction with article 24, paragraph 2, under which the registration of a notice that contains an error in the grantor's identifier might still be effective if the name that was

entered by the registrant is a sufficiently close match to result in the notice being retrieved on a search using the grantor's correct identifier.

236. Paragraph 2 obligates the Registry to issue an official search certificate setting out a search result upon the request of a searcher. Paragraph 3 dispenses with the need to obtain an official search certificate, for example, for the purposes of subsequent disputes, by providing that a written search result that purports to have been issued by the Registry is proof of its contents in the absence of evidence to the contrary. A written search result for this purpose would include a printout of a search result provided electronically.

Section F. Errors and post-registration changes

Article 24. Registrant errors in required information

237. Article 24 of the Model Registry Provisions is based on recommendations 58 and 64-66 of the Secured Transactions Guide (see chap. IV, paras. 66-74, and 82-97) and 29 of the Registry Guide (see paras. 205-220). Its overall aim is to provide guidance on when the effectiveness of a registration may be challenged owing to errors committed by registrants in entering the information in notices submitted to the Registry.

238. Paragraphs 1 and 2 address errors on the part of a registrant in entering the grantor identifier in a registered notice. Paragraph 1 provides that the effectiveness of the registration cannot be challenged if the information in the registered notice would be retrieved by a search of the public registry record using the grantor's correct identifier (determined under art. 9) as the search criterion (see option A of art. 23, and para. 221 above). Paragraph 2, which appears in square brackets, should be adopted by enacting States that implement option B of article 23 under which search requests will also retrieve registered notices in which the grantor identifiers closely match the identifier entered by a searcher (see para. 222 above). In enacting States that adopt this option, paragraph 2 provides that an error on the part of a registrant in entering the grantor identifier does not render the registration ineffective if the information in the notice would still be retrieved as a "close match" by a search using the grantor's correct identifier "unless the error would seriously mislead a reasonable searcher." For example, suppose that the registered notice identifies the grantor as "Jack McDonald" and the correct name of the grantor is in fact "John Macdonald." If the erroneous notice is retrieved as a "close match" on a search using the correct name, the degree of discrepancy between the correct name and the close match in this example may be found to constitute a seriously misleading error from the perspective of a reasonable searcher. Whether this is the

case can only be decided on the facts of each case taking into account the local context including the logic of the registry close match software.

239. Paragraph 4 deals with the impact of errors committed by registrants in entering the other items of information required to be set out in registered notices under article 8 such as errors in the description of the encumbered assets. It provides that an error does not make the registration ineffective unless it “would seriously mislead a reasonable searcher.” This language incorporates an objective test in the sense that a competing claimant who challenges the effectiveness of the registration need not show that it was actually misled by the error. It is sufficient to show that a hypothetical reasonable searcher would have been misled. This standard ensures that, for example, the grantor’s insolvency representative will be entitled to challenge the effectiveness of a registration even if it cannot show that it was itself seriously misled by the error.

240. Paragraphs 3 and 5 incorporate the general principle of severability. Thus, an error in entering the identifier of a particular grantor or the description of a particular encumbered asset that would render the registration ineffective under paragraph 1, 2 or 4 does not make the registration of the notice ineffective with respect to other grantors correctly identified or other encumbered assets correctly described in the registered notice.

241. Paragraph 6, which appears within square brackets, addresses the scenario where the enacting State allows a registrant to select the period of effectiveness of the registration of a notice pursuant to article 14, option A or B (and art. 8, subpara. (d)). In this scenario, an error in the entry of the period of effectiveness will render the registration ineffective only as against a competing claimant who can establish that it was in fact misled by the error (see Registry Guide, paras. 215 and 217-220). The application of this rule will rarely be triggered. When the error consists in entering a period that is longer than intended, third-party searchers would not generally be prejudiced, as they still would have been alerted to the fact that a security right might exist. When the error consists in entering a period that is shorter than intended, the registration will lapse at the end of the specified period and the security right will no longer be effective against third parties, unless it was made effective prior to the lapse by some other method (see Secured Transactions Guide, rec. 46).

242. Paragraph 7, which appears within square brackets, addresses the scenario where an enacting State chooses to require a registrant to indicate the maximum amount for which a security right may be enforced pursuant to article 8, subparagraph (e). It provides that while an error in the maximum amount stated in an initial or amendment notice does not render the registration ineffective, the priority of the security right is limited to the maximum amount stated in the notice or in

the security agreement, whichever is lower. This rule is consistent with the rationale for requiring the maximum amount to be stated in the security agreement and disclosed in any related registered notice (see para. 163 above).

243. As already observed (see paras. 174, and 218 above), some States provide for the entry of a serial number for specified classes of high-value assets that have a significant resale market. In States that adopt this approach, entry of this identifier in its own designated field in a notice is required in the sense of being necessary to achieve the priority of the security right as against specified classes of competing claimants. Enacting States that decide to adopt this approach will need to deal with the impact of errors in the serial number on the effectiveness of a registration for this purpose. In general, the same test should apply as for an error in the grantor's identifier. Accordingly, the registration would be ineffective against these classes of competing claimants if the information in the registered notice would not be retrieved by a search of the public registry record using the prescribed serial number. However, enacting States implementing paragraph 2 ("the close match search logic") should not extend its application to searches against serial numbers as there is too great a risk that this may result in too lengthy a list of close matches.

Article 25. Post-registration change of grantor identifier

244. Article 25 of the Model Registry Provisions is based on recommendation 61 of the Secured Transactions Guide (see chap. IV, paras. 75-77; see also Registry Guide, paras. 226-228). It addresses the impact of a post-registration change in the identifier of the grantor (i.e. its name under art. 9) on the effectiveness of the registration of a notice. Since the grantor's identifier is the principal search criterion (see art. 22, subpara. (a)), a search under the new identifier will not retrieve registered notices in which the grantor is identified by its old identifier. This poses a risk for third-party searchers that contemplate acquiring rights in the grantor's encumbered assets after the change of the grantor's identifier.

245. To address this risk, paragraphs 2 and 3 give the secured creditor a grace period to be specified by the enacting State after the change of identifier occurs to either register an amendment notice adding the new identifier of the grantor or make its security right effective against third parties by a method other than registration (on other methods, see arts. 18 and 25-27 of the Model Law). A grace period of 60 to 90 days is suggested to give the secured creditor a reasonable period to monitor and find out about the change. If neither step is taken before the expiry of the grace period, the security right is subordinated to a competing security right that was made effective against third parties after the change (see para. 2 (a)), and a buyer who acquired its rights in the encumbered asset after the change will acquire them free of the security right (see para. 3 (a)).

246. Under paragraphs 2 and 3, the secured creditor may still register an amendment notice or otherwise make its security right effective against third parties even after the expiry of the grace period. However, it loses the benefit of the grace period with the result that its security right will be subordinated to a competing security right that was made effective against third parties after the change but before the relevant step was taken, even if the competing security right was made effective against third parties before the expiry of the grace period (see para. 2 (b)). A buyer to whom the encumbered assets is sold after the change but before the relevant step was taken likewise acquires its rights free of the security right even if the sale took place before the expiry of the grace period (see para. 3 (b)). Under paragraph 4, paragraphs 2 and 3 do not apply if the information in the notice referred to in paragraph 1 would be retrieved by a search using the new identifier of the grantor as the search criterion. As indicated in the footnote to paragraph 4, this provision is necessary only if the enacting State adopts article 23, option B, paragraph 1, under which the registry system is designed to disclose on search results information in notices in which the identifier of the grantor closely matches the identifier of the grantor entered by the searcher. In a “close match” system, the search result might still retrieve the relevant notice if the subsequent change in the grantor identifier is relatively minor (for example, if Acme Co. changes its name to Acme & Co).

247. As against competing claimants other than a competing secured creditor and a buyer whose rights are specifically protected by paragraphs 2 and 3, paragraph 1 confirms that the third-party effectiveness and priority of a security right that was made effective against third parties by registration is not affected by a post-registration change in the identifier of a grantor. Thus, even if the secured creditor does not register an amendment notice or make its security right effective against third parties by a method other than registration, it will still retain whatever priority it has under the Model Law against competing secured creditors and buyers whose rights arose before the change in the identifier of the grantor and as against other classes of competing claimants whether their rights arose before or after the change of the grantor’s identifier (for example, the grantor’s judgment creditors and insolvency representative).

Article 26. Post-registration transfer of an encumbered asset

248. Article 26 of the Model Registry Provisions is inspired by recommendation 62 of the Secured Transactions Guide (see chap. IV, paras. 78-80). The Registry Guide discusses but does not make a recommendation with respect to this matter (see Registry Guide, paras. 229-232). It addresses the impact of a post-registration sale of an encumbered asset on the effectiveness of the registration of a notice in relation to a security right in that asset where the buyer acquires the asset subject

to the security right under article 34, paragraph 1, of the Model Law. This creates a risk for third parties that acquire rights in the encumbered asset from the buyer since a search of the public registry record under the identifier of the buyer will not retrieve registered notices in which the grantor identifier is the name of the seller/grantor. This risk is analogous to that addressed in article 25 in relation to post-registration changes in the grantor identifier. Unlike article 25, article 26 does not provide a uniform rule. Rather, it gives enacting States the option to enact any one of three approaches.

249. The approach in option A is identical to that set out in article 25 for post-registration changes in the grantor identifier. Paragraphs 2 and 3 give the secured creditor a grace period to be specified by the enacting State after the sale by the grantor to either register an amendment notice adding the buyer as a new grantor or otherwise make its security right effective against third parties in order to preserve its priority against secured creditors and subsequent buyers who acquire their rights in the encumbered assets from the grantor's buyer (see paras. 2 (a) and 3 (a)). As under article 25, a grace period of 60 to 90 days is suggested in order to give the secured creditor a reasonable period of time to monitor and find out about the sale by the grantor. As under paragraph 1 of article 25, paragraph 1 of article 26 provides that the secured creditor's failure to take either of these steps before the expiry of the grace period, or at all, does not generally prejudice the third-party effectiveness and priority status of its security right. However, its security right will be subordinated to competing security rights created by the buyer from the grantor and made effective against third parties after the sale, and before the relevant step is taken (see para. 2 (b)). A subsequent buyer to whom the buyer from the grantor sells the encumbered asset during this same period also acquires its rights free of the security right (see para. 3 (b)).

250. The approach in paragraphs 1-3 of option B is similar to the approach in paragraphs 1-3 of option A, with the important qualification that the grace period under paragraphs 2 and 3 to register the amendment notice or otherwise make the security right effective against third parties begins only when the secured creditor acquires knowledge: (a) that the grantor has sold the encumbered asset; and (b) of the identity of the buyer, and not simply when the sale takes place, as under paragraphs 2 and 3 of option A. In view of this difference, a grace period of 15 to 30 days is suggested.

251. If there are successive sales of an encumbered asset before the secured creditor acquires knowledge of the sale and the identity of the buyer, paragraph 4 of option B provides that it is sufficient, to protect its rights under paragraphs 2 and 3 against intervening secured creditors and buyers, if the secured creditor registers an amendment notice adding the identifier of the most recent buyer of whose identity it has knowledge.

252. Paragraph 4 of option A and paragraph 5 of option B provide that a security right in intellectual property made effective against third parties by registration of a notice generally retains its third-party effectiveness and priority status including as against secured creditors and buyers who acquire their rights from a buyer to whom the grantor sold the intellectual property after the notice was registered. This approach reflects recommendation 244 of the Intellectual Property Supplement. In the intellectual property context, it was thought that the risks posed for third-party searchers by the grantor's sale of intellectual property outweighed the burden that would be imposed on secured creditors if they were required to register an amendment notice each time intellectual property was sold (see Intellectual Property Supplement, rec. 244 and paras. 158-166).

253. Under option C, the third-party effectiveness and priority of a security right that is made effective against third parties by registration of a notice is not affected by a post-registration sale of an encumbered asset covered by the registered notice. The secured creditor retains whatever priority it otherwise has under the Model Law against all competing claimants, whether their rights arise before or after the sale. This option extends the approach to the impact of post-registration sales of encumbered intellectual property in paragraph 4 of option A and paragraph 5 of option B to all types of encumbered asset. Under this approach, potential secured creditors and buyers are expected to inquire into the chain of ownership of the asset they are interested in and then conduct searches against the identifier of both the immediate owner and any predecessors in the chain of title.

Section G. Organization of the Registry and the registry record

Article 27. The registrar

254. Article 27 of the Model Registry Provisions is based on recommendation 2 of the Registry Guide (see para. 74; the Secured Transactions Guide does not contain an equivalent recommendation). Recognizing that these matters may be dealt with differently in each State, article 27 leaves it to the enacting State to specify in the law, regulation or other act by which it implements the Model Registry Provisions the authority responsible for the appointment and dismissal of the registrar, and for determining the registrar's duties and monitoring their performance.

255. While an enacting State may decide to have the day-to-day operations of the Registry carried out by either a private or public entity, the Registry and the registrar should always be subject to the ultimate direction of, and be accountable to, the authority designated by the enacting State. Depending on local

considerations, the public authority specified by the enacting State may be a governmental ministry responsible for the preparation of the secured transactions law, another public agency, or a department of a central bank (see Registry Guide, para. 77).

Article 28. Organization of information in the registry record

256. Article 28 of the Model Registry Provisions is based on recommendations 15 and 16 of the Registry Guide (see paras. 127-130; the Secured Transactions Guide does not contain an equivalent recommendation). Paragraph 1 requires the Registry to assign a unique registration number to an initial notice and to associate all registered amendment and cancellation notices that contain that number with the initial notice in the registry record. These requirements ensure that information in all related notices is disclosed on a search result (see the definition of the term “registration number” in art. 1, subpara. (j), as well as arts. 17, 19 and 22, subpara. (b)).

257. If paragraph 2 of option A is adopted, the enacting State must ensure that the registry system is designed so that search results will only retrieve information in registered notices that exactly match the grantor identifier entered by the searcher (see option A of art. 23, para. 1). If paragraph 2 of option B is adopted, the enacting State must ensure that the registry system is designed to also retrieve information in registered notices in which the grantor’s identifier closely matches the identifier entered by the searcher (see art. 23, option B, para. 1).

258. Paragraph 3 of option A is intended for enacting States that permit a person to register a global amendment notice changing its identifier or address or both in all registered notices in which it is identified as the secured creditor (see option A of art. 18). Option B of paragraph 3 is intended for enacting States in which the global amendment must be effected by the Registry at the request of the secured creditor (see art. 18, option B).

259. Paragraph 4 is intended to ensure that the entire registration record relating to an initial notice remains intact. It provides that the registry record must be organized in a manner that preserves the information in all registered notices, notwithstanding the registration of an amendment or cancellation notice that purports to change the information contained in previously registered notices.

260. As already noted (see paras. 155, and 189 above), article 5, paragraph 2 requires a person who submits an amendment or cancellation notice to satisfy the

secure access requirements prescribed by the enacting State. The enacting State will also need to impose additional organizational obligations on the Registry should it decide to provide for: (a) registration and searching according to serial number (see paras. 174, and 218 above); or (b) registration and searching according to a grantor identifier other than the name of the grantor (see para. 162 above).

Article 29. Integrity of information in the registry record

261. Article 29, paragraph 1, of the Model Registry Provisions is based on recommendation 17 (a), of the Registry Guide (see para. 136; the Secured Transactions Guide does not contain an equivalent recommendation). It prohibits the Registry from amending or removing information in the registry record except as authorized in articles 30 and 31.

262. Article 29, paragraph 2, of the Model Registry Provisions is based on recommendations 55 (f) of the Secured Transactions Guide (see chap. IV, para. 54), and 17(b) of the Registry Guide (see para. 137). It obligates the Registry to ensure that the information in the registry record is preserved and may be reconstructed in the event of loss or damage. In practice, this obligation requires the Registry to create and maintain a backup copy of the registry record.

Article 30. Removal of information from the public registry record and archival

263. Article 30, option A, of the Model Registry Provisions is based on recommendations 74 of the Secured Transactions Guide (see chap. IV, para. 109), as well as recommendations 20 and 21 of the Registry Guide (see paras. 151-152). It requires the Registry to remove information in registered notices from the public registry record once the period of effectiveness of the notice expires or a cancellation notice is registered. The removed information will have to be archived in the (non-public) registry record. If the information in cancelled or expired notices were to remain publicly searchable, this might create legal uncertainty for third-party searchers, potentially impeding the ability of the grantor to grant a new security right in or deal with the assets described in the notice (see Registry Guide, para. 151). Option A should be enacted by States that adopt option A or B of article 21 (see paras. 208-210 above).

264. Article 30, option B, of the Model Registry Provisions should be enacted by States that adopt option C or D of article 21 (see paras. 211-214 above). Paragraph 1 of option B requires the Registry to remove information in registered notices from the public registry record once the period of effectiveness of the

registration of a notice expires. Unlike option A, paragraph 2 of option B requires the Registry to preserve all information in registered notices on the public registry record notwithstanding the registration of a cancellation notice. This is necessary since the registration of an amendment or cancellation notice is wholly or partially ineffective under article 21, option C or D, if it is not authorized by the secured creditor of record. Since the factual question of whether the secured creditor of record authorized the registration of a cancellation notice can only be answered by conducting off-record inquiries, it is necessary to preserve the information in the cancellation notices and all related registered notices on the public registry record so that searchers have the information needed to conduct those inquiries.

265. Paragraph 3 requires the Registry to archive the information in registered notices removed from the public registry record in a manner that enables the information to be retrieved in accordance with the search criteria set out in article 22. This is necessary since the information in notices removed from the public registry record may need to be retrieved in the future, for example, in order to determine the time of registration or the scope of the encumbered assets described in the notice for the purposes of a subsequent priority dispute between the secured creditor and a competing claimant (see Registry Guide, para. 151).

266. As to the duration of the Registry's archival obligation, paragraph 3 leaves this decision to the enacting State (while cautioning that it should minimally be coextensive with the prescription period under local law for disputes arising in relation to a security agreement).

Article 31. Correction of errors made by the Registry

267. Article 31 of the Model Registry Provisions addresses the effect of errors and omissions made by the Registry in two scenarios. The first is where the Registry makes an error or omission in entering into the public registry record information contained in a notice submitted for registration. The need to address this scenario arises only if the registry system implemented by a State allows the submission of notices in paper form as opposed to requiring all registrants to transmit the information in notices directly to the registry via electronic means. The second scenario addressed by article 31 is where the Registry erroneously removes from the registry record information contained in a registered notice. The need to address this second scenario arises even in systems in which notices may only be submitted directly to the Registry via electronic means.

268. Paragraph 1 of article 31 requires the Registry to take steps to correct the error or restore the erroneously removed information without delay after discovering the error. Under option A, the Registry is required to take the necessary

corrective action and must then send to the secured creditor of record a copy of the notice it registered to correct the record. Under option B, the Registry is instead required to inform the secured creditor of record of the error to enable it to register the notice needed to correct the record. Nothing in this article precludes the secured creditor from registering an amendment notice to correct the error if it discovers it before the Registry does or before it receives notification from the Registry.

269. Paragraph 2 addresses the impact of the Registry's error on the third-party effectiveness and priority status of the security right affected by the error as against the right of a competing claimant which arose prior to the registration of the notice correcting the record referred to in paragraph 1. It offers four options that parallel the four options in article 21 with respect to the effectiveness of the unauthorized registration of an amendment or cancellation notice. The enacting State should adopt the option in article 31 that corresponds to the option it selects in article 21. Accordingly, a State that adopts article 21, option A, should adopt article 31, option A and so on.

Article 32. Limitation of liability of the Registry

270. Article 32 of the Model Registry Provisions is drawn from recommendation 56 of the Secured Transactions Guide (see chap. IV, paras. 55-64; see also the Registry Guide, paras. 141-144). It offers three options to an enacting State in dealing with the potential liability of the Registry for loss or damage caused by its errors or omissions. It should be noted that especially in a fully electronic system in which registration and search information is submitted directly by users via electronic means, the risk of loss or error being caused by the Registry is extremely low. Nonetheless, the objective of all options is to limit the liability of the Registry and to thus avoid an increase in the cost of the registry services in the rare event where loss or damage can be attributed to acts or omissions of the Registry. The enacting State should coordinate article 32 with its relevant law on the liability of public authorities.

271. Option A leaves the issue of the liability of the Registry to other law of the enacting State. If liability is foreseen by that other law, option A restricts any right of recovery to the types of errors or omissions listed in paragraph 1. Thus, liability is limited to: (a) errors or omissions in a search result issued to a searcher (para. 1 (a)); (b) errors or omissions in a copy of information in a registered notice sent to a secured creditor under article 15 or the failure of the Registry to send a copy of a registered notice as required by that article or article 31 (para. 1 (a) and (c)); and (c) the provision of false or misleading information to a registrant or searcher (para. 1 (d)).

272. The first part of paragraph 1 (b) of option A appears within square brackets as it limits any liability that the Registry may have under other law for errors or

omissions in registered notices to the situation where the Registry is responsible for entering into the registry record information that is submitted by a registrant in a paper notice. Accordingly, paragraph 1 (*b*) should only be adopted by an enacting State if its registry system permits the submission of notices to the Registry using paper forms.

273. To minimize the risk of Registry liability for providing misleading advice (see para. 1(*d*) of option A), the enacting State should ensure that registry staff are trained to restrict their advice to the technical aspects of using the registry system, and not the legal implications or effects of registration (see Registry Guide, para. 139).

274. Paragraph 2 of option A limits the liability of the Registry for loss or damage caused by the acts or omissions specified in paragraph 1 to the maximum monetary amount specified by the enacting State (regardless of the maximum value of the encumbered assets or the obligation secured by those assets).

275. Like option A, option B leaves to other law any liability that the Registry may have for loss or damage caused by an error or omission in the administration or operation of the Registry. Unlike option A, option B does not restrict any right of recovery that a person may have under other law to specific types of errors or omissions. However, if the registry system is designed to permit direct registration and searching by registry users without the intervention of registry personnel, what constitutes an error or omission should be generally limited to system malfunction. Like option A, option B limits the Registry's liability to the maximum amount specified by the enacting State.

276. Option C simply excludes any liability of the Registry for an error or omission in the administration or operation of the Registry.

Article 33. Registry fees

277. Article 33 of the Model Registry Provisions is generally based on recommendations 54 (*i*) of the Secured Transactions Guide (see chap. IV, para. 37) and 36 of the Registry Guide (see paras. 274-280). Article 33 presents two options.

278. Under paragraphs 1 and 3 of option A, fees may be charged for the provision of registry services in the amounts specified by the enacting State and the fee schedule must be publicized by the Registry. Fees should be set at a cost-recovery level (see Secured Transactions Guide, rec. 54 (*i*)). The requirement to set fees on a cost-recovery basis applies to all services provided by the registry, including the registration of all types of notice and all search services. If the registry system were instead used by the enacting State to generate profit, registrants and searchers might be discouraged from using the registry services. To ensure that these fees are based

on cost recovery, paragraph 2 of option A entitles the authority responsible for the appointment of the registrar under article 27 to periodically modify the fee schedule.

279. If the registry system allows access both by electronic means and through the submission of written notices and search requests, the enacting State might decide to charge a lower fee to users who access the registry electronically because electronic registration and searching do not require the intercession of registry staff and therefore are less costly. This approach might also encourage users to shift to this more efficient method in preference to continuing to use paper forms.

280. To enhance the efficiency of the payment process for frequent users of registry services, paragraph 4 of option A authorizes the Registry to enter into an agreement with any person to establish a Registry user account for any purpose, including the payment of registry fees. This approach has the additional advantage of facilitating the identification of the registrant for the purposes of article 5 (see para. 154).

281. A variant of option A would be to limit the charging of fees to registrations and allow searches to be made free of charge. This variant would encourage and facilitate due diligence by potential secured creditors and buyers and thereby reduce risk and future disputes.

282. Another variant of option A would be for the enacting State to decide not to charge any fee for the registration of the types of amendment and cancellation notices contemplated by article 20. This variant would encourage the secured creditor to promptly register amendment and cancellation notices in the circumstances contemplated by article 20 and relieve grantors from the time and expense of having to initiate formal proceedings to force cancellations or amendments under that article.

283. For enacting States that enact option B or C of article 14 (allowing a registrant to select the duration of the registration of a notice), yet another variant of option A would be to charge fees on a sliding scale depending on the period selected by the registrant. This approach would have the advantage of discouraging registrants from selecting an inflated period of effectiveness of a registration out of an excess of caution (see Registry Guide, para. 277).

284. Option B provides that the Registry may not charge any fees for its services. Under this approach, the cost of establishing and operating the Registry will be covered by general State revenues. Option B may be attractive to enacting States that seek to encourage secured financing in general and the use of the Registry in particular. Like option A, option B could have several variants. For example, the

enacting State may wish to consider offering free registration services for a limited start-up period only in order to facilitate acclimatization to and use of the registry system.

Chapter V. Priority of a security right

A. General rules

Article 29. Competing security rights created by the same grantor

285. Article 29 is based on recommendation 76 of the Secured Transactions Guide (see chap. V, paras. 45-54). It addresses priority competitions between security rights created by the same grantor. Article 29 divides these priority competitions into three categories. Subparagraph (a) addresses priority competitions between security rights made effective against third parties by registration of a notice in the Registry. Subparagraph (b) addresses priority competitions between security rights made effective against third parties by a method other than registration of a notice in the Registry. Subparagraph (c) addresses priority competitions between a security right that is made effective against third parties by registration of a notice in the Registry and a security right that is made effective against third parties by another method (e.g. possession). The general priority rules of article 29 are, however, subject to certain exceptions (see arts. 33, 38, 39 and 41-43).

286. Subparagraph (a) addresses the most common situation, that is, priority competitions between security rights all of which were made effective against third parties by registration of a notice in the Registry. In that situation, priority is determined by the order of registration, regardless of the order of creation (if the competing security rights have actually been created when the priority competition arises). Subparagraph (a) provides a simple and easy-to-apply priority rule.

287. It should be noted that the first-to-register priority rule in subparagraph (a) applies even if one or more of the competing security rights had not been created at the time of registration (registration of a notice may precede creation of a security right; see art. 4 of the Model Registry Provisions) and, thus, was not effective against third parties at the time of registration (as a security right that has not yet been created cannot be effective against third parties).

288. The following example illustrates this aspect of the first-to-register priority rule in subparagraph (a). On Day 1, before entering into a security agreement and obtaining any credit, Grantor authorized SC 1 to register, and SC 1 registered, a notice listing Grantor as the grantor and describing the encumbered assets as “all

present and future equipment of Grantor”. On Day 2, Grantor entered into a security agreement with SC 2 that created in favour of SC 2 a security right in the same assets (i.e. all of Grantor’s present and future equipment) and obtained credit from SC 2, and SC 2 registered a notice with respect to that security right. On Day 3, Grantor concluded a security agreement with and borrowed money from SC 1 and created in favour of SC 1 a security right in all of Grantor’s present and future equipment. In this case, the security right of SC 2 became effective against third parties before the security right of SC 1 (because SC 1’s security right could not become effective against third parties until it was created). Yet, as a result of the first-to-register rule in subparagraph (a) the time of registration of SC 1’s notice, rather than the later time on which SC 1’s security right became effective against third parties, is used to determine priority. Thus, the security right of SC 1 has priority over the security right of SC 2 because SC 1’s notice was registered before SC 2’s notice.

289. Ordering priority according to the time of registration as opposed to the time of creation of a security right promotes efficiency and fairness for three reasons. First, the time of registration of each notice is recorded by the Registry and set out in the search result (see arts. 13, para. 3, and 23, para. 1, of the Model Registry Provisions, and paras. 191 and 234 above) and is therefore easily ascertainable by third-party searchers. In contrast, the time of creation of a security right depends on background facts that are not ascertainable by a search of the Registry, and are not otherwise publicly available.

290. Second, the results that follow from the application of the rule in subparagraph (a) are consistent with the expectations of prudent secured creditors. For example, assume that SC 2 is considering extending credit to Grantor, secured by a security right in Grantor’s equipment. If SC 2 searches the records of the Registry and discovers that a notice has been registered that lists Grantor as the grantor and SC 1 as the secured creditor and that describes the encumbered asset as including Grantor’s equipment, SC 2 would probably expect that the registered notice reflects an existing or contemplated security right in that equipment. Accordingly, if SC 2 decides to go forward with the transaction, it will do so on the understanding that its security right may be subordinate to that of SC 1 (unless SC 1 and SC 2 enter into a subordination agreement; see art. 43, and paras. 342 and 343 below).

291. Third, the rule in subparagraph (a) enables a prospective secured creditor to determine the priority of its security right over competing security rights with a level of certainty that promotes the extension of secured credit. The reason is that, if the prospective secured creditor registers a notice with respect to its security right before it actually extends credit and there is no other notice registered in the Registry at the time that secured creditor does so, it can enter into a security

agreement and extend credit knowing that its security right will have first priority (unless any of the exceptions to the first-to-register rule apply).

292. Subparagraph (b) addresses priority competitions in which the competing security rights have all been made effective against third parties by a method other than registration of a notice in the Registry. This situation will not arise frequently as for most types of encumbered asset it will be very difficult that two different secured creditors make their security rights in the same asset effective against third parties by a method other than registration at the same time. This is because the only other method of achieving third-party effectiveness for most types of encumbered asset will be by the secured creditor obtaining possession of the encumbered asset, and it would be unlikely that two different secured creditors can have possession of the same asset at the same time. It is, however, possible, as illustrated by the following example. On Day 1, Grantor grants to SC 1 a security right in a painting and the security right is made effective against third parties by delivering the possession of the painting to a depositary who agrees to hold the painting on behalf of SC 1. On Day 2, Grantor grants to SC 2 a security right in the same painting. In order to make the security right of SC 2 effective against third parties, Grantor, SC 1, SC 2 and the depositary agree that the possession of the painting by the depositary will also be for the benefit of SC 2. Should a competition arise between SC 1 and SC 2, SC 1 will have priority because its security right was made effective against third parties by possession through the depositary. It is only on Day 2 that the depositary started to hold the painting also for the benefit of SC 2 (with the result that SC 2's security right became effective against third parties after that of SC 1). The asset-specific priority rules in this chapter provide for other situations where two secured creditors may achieve third-party effectiveness of their security rights in the same asset by a method other than registration. However, in most of these other situations, asset-specific priority rules are provided by the Model Law (see arts. 47, para. 4, and 51, para. 4, and paras. 353 and 365 below).

293. Subparagraph (c) addresses priority competitions between a security right that is made effective against third parties by registration of a notice in the Registry and a security right that is made effective against third parties by another method (e.g. by possession of the encumbered asset). In this situation, the time of registration of the security right that is made effective against third parties by registration is compared to the time of third-party effectiveness of the competing security right, and priority is determined according to the order of registration or third-party effectiveness. As in the case of the rule in subparagraph (a), the time of registration of a registered security right is used to determine priority even if the security right is not created until after the notice is registered (see paras. 286-288 above). For example, assume that: (a) on Day 1, SC 1 registers a notice describing an asset (with Grantor's consent); (b) on Day 2, Grantor creates a security right in the asset to SC 2, and SC 2 takes possession of the asset; and (c) on Day 3, Grantor enters

into a security agreement with SC 1 that creates a further security right in the asset in favour of SC 1. Even though SC 2's security right was created first, SC 1 will have priority, because its notice was registered before SC 2 took possession.

294. There may be cases where a secured creditor has used more than one method to make its security right effective against third parties. For example, a secured creditor in possession of an encumbered asset may subsequently register a notice with respect to that security right in the Registry, or vice versa. In this situation, the earlier priority time (i.e. when the security right was first registered or made effective against third parties) continues to be used in applying the general priority rules in article 29, unless there is a "gap" during which the security right was neither effective against third parties nor the subject of a notice registered in the Registry (see art. 31, and para. 296 below).

Article 30. Competing security rights created by different grantors

295. Article 30 addresses priority competitions between security rights created by different grantors in the same encumbered asset. This situation can occur, for example, if a grantor creates a security right in its equipment in favour of a secured creditor (SC 1 in the example given in para. 292 above) and then sells the equipment to a person that creates a security right in it in favour of a different secured creditor (SC 2). Article 30 provides that the general priority rules in article 29 apply in this situation as well, except as provided in article 26 of the Model Registry Provisions (see paras. 248-253 above). Under options A and B of article 26 of the Model Registry Provisions, SC 2 may have priority if SC 1 did not preserve the third-party effectiveness of its security right as against secured creditors in the position of SC 2 by taking the steps provided for in one of those options.

Article 31. Competing security rights in the case of a change in the method of third-party effectiveness

296. Article 31 addresses situations in which there has been a change in the method of third-party effectiveness (which requires that a security right has been validly created under art. 6 and that one of the methods of third-party effectiveness, set out, for example, in art. 18, has been complied with). This may happen, for example, where a secured creditor makes its security right effective against third parties by possession of the encumbered asset and subsequently registers a notice with respect to its security right. In such a case, for the purposes of applying the general priority rules in article 29, the priority of the security right is determined by the time when it initially became effective against third parties so long as there

was no time thereafter during which the security right was not effective against third parties. So, if the secured creditor in this example registers before it returns possession of the encumbered asset to the grantor, its priority will date from the time when it obtained possession, not the time of the later registration.

Article 32. Competing security rights in proceeds

297. Article 32 is based on recommendation 100 of the Secured Transactions Guide (see chap. V, paras. 144-150). It addresses priority competitions between security rights in assets that are proceeds (for the definition of the term “proceeds”, see art. 2, subpara. (bb), and para. 59 above). Situations in which a secured creditor has a security right in proceeds are quite common, particularly when the original encumbered asset is inventory or a receivable, as a grantor will frequently sell inventory or collect a receivable before satisfaction of the obligation secured by that asset. In such a case, under article 10, the security right continues in the proceeds that are derived from the sale of the inventory or the collection of the receivable, and the security right in the proceeds is effective against third parties if the conditions in article 19 are satisfied (see paras. 125-128 above). Article 32 then determines the priority of that security right as against another security right in the same asset, whether the other security right is over the asset as an original encumbered asset or as proceeds. Article 32 provides that the priority of the security right in the proceeds is the same as the priority of the security right in the original encumbered asset.

298. The following example illustrates the operation of article 32. On Day 1, Grantor creates in favour of SC 1 a security right in all of Grantor’s present and future inventory and SC 1 registers a notice with respect to that security right. On Day 2, Grantor creates in favour of SC 2 a security right in all of Grantor’s present and future receivables and SC 2 registers a notice with respect to that security right. On Day 3, Grantor sells some of its inventory on credit, generating a receivable. SC 1 has a security right in that receivable under article 10 because it is proceeds of the inventory in which SC 1 had a security right and its security right in the receivable as proceeds is automatically effective against third parties under article 19. SC 2 has a security right in that receivable as an original encumbered asset, because of its security right in all present and future receivables of Grantor. Under the priority rules in article 29, SC 1’s security right in the receivable has priority over SC 2’s security right in the receivable because the priority of SC 1’s security right in the receivable (as proceeds) is determined under article 32 by the time of registration of SC 1’s notice with respect to its security right in the inventory (as original encumbered assets). Thus, SC 1’s priority in the receivable dates from Day 1, while SC 2’s priority in the receivable dates from Day 2 (for the priority of a security right in proceeds of inventory subject to an acquisition security right, see art. 41, and paras. 335-340 below).

Article 33. Competing security rights in tangible assets commingled in a mass or transformed into a product

299. Article 33 addresses priority competitions resulting from situations in which the original encumbered assets are commingled in a mass or transformed into a product (see Secured Transactions Guide, chap. V, paras. 117-124 and recs. 90 and 91). Under article 11, a security right in the original encumbered assets automatically extends to the mass or product and, under article 20, the security right in the mass or product is automatically effective against third parties.

300. Paragraph 1 of article 33 addresses the situation in which the competing security rights that extended to the mass or product were originally in the same encumbered asset. In this situation, the order of priority of the security rights in the mass or product is the same as the order of priority of the security rights in the original encumbered asset. For example, if SC 1 has a first-ranking security right in 100,000 litres of oil and SC 2 has a second-ranking security right in the same 100,000 litres of oil and the oil is then commingled with another 100,000 litres of oil in the same tank so that the mass comprises 200,000 litres of oil, under paragraph 1 of article 33, the security right of SC 1 will continue to rank ahead of the security right of SC 2 in relation to the commingled mass. Under article 11, paragraphs 1 and 2, however, the security rights of SC 1 and SC 2 are both limited to half of the oil in the tank (i.e. 100,000 litres).

301. Paragraphs 2 and 3 address the situation in which competing security rights that extended to the mass or product were originally in different encumbered assets. In this situation, paragraph 2 provides that the secured creditors share in the mass or product according to the ratio that the obligation secured by each of their security rights bears to the sum of the obligations secured by all those security rights. Paragraph 3 provides that the determination of the amount of the obligations secured by the competing security rights is subject to the limitation on the amount of the obligation that is set out in article 11, paragraphs 2 and 3.

302. The following example illustrates the operation of the limitations in paragraphs 2 and 3. SC 1 has a security right in flour worth €100 to secure a loan of €100 and SC 2 has a security right in yeast worth €20, also to secure a loan of €100. The flour is mixed with the yeast to make bread. Paragraph 2 starts by providing that SC 1 and SC 2 would share in the value of the bread 50/50 (as they were both owed the same amount, i.e. €100). Paragraph 3 overrides this, however, by capping the amount of SC 2's loan, for the purposes of this calculation, at the value of the yeast (i.e. €20), so that SC 2 will only be entitled to 1/6 of the value of the bread (20/120). If the bread is worth €120 (or more), then this will not matter, as there will be sufficient value for SC 1 to recover its €100, and for SC 2 to recover its €20, in full. If the value of the bread goes down to €60 (i.e. becomes

insufficient to satisfy the secured claims in full), then SC 1 will be paid 5/6 of the value of the bread (i.e. €50) and SC 2 will be paid only 1/6 of the value of the bread (i.e. €10).

Article 34. Security rights competing with rights of buyers or other transferees, lessees or licensees of an encumbered asset

303. Article 34 is based on recommendations 79-82 of the Secured Transactions Guide (see chap. V, paras. 60-89). It determines the rights of a buyer or other transferee, lessee or licensee of an encumbered asset vis-à-vis a security right. Paragraph 1 states the general rule that a security right in an encumbered asset that is effective against third parties continues to encumber the asset notwithstanding its sale or other transfer, lease or licence. Paragraphs 2-6 provide exceptions to this general rule.

304. Paragraph 2 provides that, if the secured creditor authorizes the sale or other transfer of the encumbered asset free of the security right, the buyer or other transferee acquires its rights in the asset free of that security right. This rule recognizes that a secured creditor is always free to voluntarily release its security right in an asset. In practice, a secured creditor may be prepared to do this where: (a) the secured creditor and grantor have arranged for the proceeds of the sale or transfer to be remitted directly to the secured creditor in satisfaction of the secured obligation; or (b) the buyer or other transferee has agreed to assume the grantor's obligation to the secured creditor.

305. Paragraph 3 sets out a similar rule, for a situation where the secured creditor agrees that the grantor may lease or license the encumbered asset. It is formulated differently from the rule in paragraph 2 (the rights of a lessee or licensee "are not affected by" the security right) because the secured creditor's authorization only entitles the lessee or licensee to enjoy undisturbed possession of the leased or licensed asset during the term of the lease or licence as opposed to acquiring ownership free of the security right as in the case of an authorized sale or other transfer.

306. Paragraph 4 provides that a buyer of a tangible asset that is sold in the ordinary course of business of the seller acquires its rights free of any security right created by the seller in that asset. It should be noted that the term "tangible asset" for the purposes of this rule excludes money, negotiable instruments, negotiable documents and certificated non-intermediated securities (see art. 2, subpara. (ll)). What constitutes a sale in the ordinary course of the seller's business requires a fact-specific analysis. Thus, for example, the sale by the grantor of some of its inventory in accordance with its usual business practices would satisfy this condition, but a one-time sale of a used item of equipment may not.

307. It should be noted that this rule applies only to buyers, and not to other transferees. This means that it would not apply to a person that takes an encumbered asset as a gift, rather than by purchasing it (with respect to the question whether remote buyers, lessees and licensees, see Secured Transactions Guide, chap. V, paras. 84-88).

308. A buyer may be protected by paragraph 4 even if the buyer knew of the existence of the security right, unless it also knew that the sale breached the secured creditor's rights under its security agreement with the grantor. If, for example, a buyer knows that the seller has entered into a security agreement that limits the grantor's authority to deal in its inventory, but does not know that the sale is in breach of that limitation, the buyer can acquire the asset free of the security right.

309. Paragraphs 5 and 6 bring about similar results to those in paragraph 4 in the case of leases of tangible encumbered assets and non-exclusive licences of encumbered intellectual property that are in each case leased or licensed by the grantor in the ordinary course of its business. The formulation of paragraphs 5 and 6 differs from the formulation of paragraph 4. The reason is that, in the case of a lease or licence concluded in the ordinary course of the grantor's business, the effect of the exception is to entitle the lessee or licensee to enjoy undisturbed use of the leased or licensed asset during the term of the lease or license and does not involve the transfer to it of the ownership of the asset.

310. Paragraphs 7 and 8 state what is often referred to as the "shelter principle". Under this principle, once a buyer or other transferee, lessee, or licensee obtains rights in the encumbered asset free of (or unaffected by) a security right, subsequent buyers or other transferees also acquire their rights in the encumbered assets free of (or unaffected by) that security right.

311. Paragraph 9 protects a buyer or lessee of low-value consumer goods that are subject to an acquisition security right that was made effective against third parties automatically under article 24 (and not, for example, by registration). In this situation, the buyer or lessee acquires its rights free of or unaffected by the security right. If a secured creditor wishes to avoid this risk, it should register a notice of its acquisition security right.

Article 35. Impact of the grantor's insolvency on the priority of a security right

312. Under article 35, a security right that is effective against third parties remains effective against third parties. It also retains its priority as against competing

claimants notwithstanding the commencement of insolvency proceedings with respect to the grantor. This is subject to the insolvency law of the enacting State, which may give superior priority to the rights of another claimant (e.g. the insolvency representative for the costs of the insolvency proceedings). The rule in article 35 is extremely important in creating a legal environment that promotes the extension of secured credit, because a security right that is not recognized in insolvency proceedings, or that loses its priority because of the commencement of insolvency proceedings, is of little value to a prospective secured creditor.

Article 36. Security rights competing with preferential claims

313. Article 36 is based on recommendations 83, 85 and 86 of the Secured Transactions Guide (see chap. V, paras. 90-93 and 103-109). It provides a framework for the enacting State to implement the policy of these recommendations by requiring it to: (a) list in a clear and specific way any claims that will have priority over security rights; and (b) specify a cap on the amount of the claim given priority. This requirement is intended to ensure that secured creditors are aware of the existence of any preferential claims and their maximum amounts, and thus can take them into account before lending. For example, secured creditors may deduct the potential amount of the preferential claims from the amount that they are prepared to lend based on the value of the encumbered assets on which they are relying. In specifying the preferential claims that have priority over a security right, the enacting State should also indicate whether these claims are given priority generally or only if insolvency proceedings involving the grantor are commenced (see Secured Transactions Guide, rec. 239).

314. Examples of claims that some States have determined should have priority over a competing security right include: (a) short-term claims of unpaid suppliers of goods; (b) rights of retention of unpaid creditors who have rendered services such as repair services with respect to encumbered assets; (c) claims of the grantor's employees for employment benefits; and (d) tax claims.

315. It should be noted that secured creditors typically require grantors to disclose the existence of preferential claims. However, if a grantor does not comply with this obligation the secured creditor has only an unsecured claim against the grantor for breach of contract, and a claimant listed by the enacting State in this article as having priority retains that priority to the extent stated in this article,.

316. It should also be noted that, some States require a notice of preferential claims to be registered in the Registry. In some of those States, the priority of a registered preferential claim is subject to the general first-to-register priority rule. This approach is useful only if the registered notice states the maximum amount

of the claim and the scope of the grantor's assets that are subject to that claim so as to enable potential secured creditors to make an informed decision about whether to extend credit and, if so, on what terms. In other States, registered preferential claims have priority even over security rights that were previously registered or otherwise made effective against third parties. In those other States, requiring registration of preferential claims is of limited value to secured creditors (see Registry Guide, paras. 46 and 51).

Article 37. Security rights competing with rights of judgment creditors

317. Article 37 is based on recommendation 84 of the Secured Transactions Guide (see chap. V, paras. 94-102). It determines priority as between a security right in an encumbered asset and the right of a judgment creditor that has taken whatever steps are necessary to acquire rights in the grantor's assets under other law of the enacting State. Paragraph 1 gives priority to the right of the judgment creditor if the required steps are taken before the security right becomes effective against third parties. The enacting State should complete paragraph 1 by inserting the relevant steps, or a reference to the other law that specifies those steps. In some States, the relevant step may be registration of a notice of the judgment in the security rights registry. In other States, the relevant step may be seizure of the grantor's assets or service of a garnishment order on a person against whom the grantor has a claim for payment of money.

318. Paragraph 2 provides that the security right has priority over the right of the judgment creditor if the judgment creditor does not acquire rights in the encumbered asset before the security right becomes effective against third parties. The same rule applies in the rare situation in which the judgment creditor acquired its rights in the encumbered asset at the same time as the security right became effective against third parties (this may occur where the encumbered assets are future assets). This rule protects a secured creditor against the possibility that its security right might otherwise be subordinate to the right of a judgment creditor that did not exist at the time the secured creditor made its security right effective against third parties.

319. However, paragraph 2 limits the extent of the priority of the security right over the right of the judgment creditor to: (a) credit extended by the secured creditor before the expiry of a short period of time to be specified by the enacting State (e.g. 15 days) after the judgment creditor notifies the secured creditor that it has taken the steps described in paragraph 1; or (b) credit extended pursuant to an irrevocable commitment made before receipt of that notification to extend credit in a fixed amount or in an amount fixed pursuant to a specified formula.

This rule prevents the secured creditor from using its priority status by increasing the secured obligation even after the secured creditor acquires actual knowledge of the rights of the judgment creditor, while giving the secured creditor a short time period to adjust to the existence of those rights.

Article 38. Acquisition security rights competing with non-acquisition security rights

320. Article 38 is based on recommendation 180 of the Secured Transactions Guide (see chap. IX, paras. 131, 136, 137, 143 and 146) and recommendation 247 of the Intellectual Property Supplement (see paras. 259-263). Two options are provided for the enacting State. Under both options, provided that the specified conditions are satisfied, an acquisition security right has priority over a competing non-acquisition security right in the same encumbered asset including a prior non-acquisition security right that otherwise would have had priority over the acquisition security right under the general priority rules in article 29 (see paras. 285-294 above).

321. A “super-priority” rule for acquisition security rights is a feature of the law of most States. In some States, it is formulated as a specific priority rule as in the Model Law. In other States, it is formulated as a necessary implication of ownership of the encumbered asset being retained by a seller or lessor under a retention-of-title sale or a financial lease agreement (under art. 2, subpara. *(kk)*, a seller’s or lessor’s ownership rights under a retention-of-title sale or a financial lease agreement is a security right). Article 38 preserves this advantageous treatment of acquisition finance, extending it to credit supplied by bank lenders as well as sellers and lessors.

322. Option A contains three “super-priority” rules. Which of the three rules applies will depend on the nature of the encumbered assets. The rule in paragraph 1 applies if the encumbered assets are equipment or its intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property that is primarily used or intended to be used by the grantor in the operation of its business; see art. 2, subpara. *(l)*, and para. 46 above). The rule in paragraph 2 applies if the encumbered assets are either inventory or its intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property held by the grantor for sale or licence in the ordinary course of the grantor’s business; see art. 2, subpara. *(q)*, and para. 50 above). The rule in paragraph 3 applies if the encumbered assets are consumer goods or their intellectual property equivalent (that is, intellectual property or rights of a licensee under a licence of intellectual property used or intended to be used by the grantor primarily for personal, family or household purposes; see art. 2, subpara. *(f)*, and para. 42 above).

323. Under the “super-priority” rule in paragraph 1 of option A, an acquisition security right in equipment or its intellectual property equivalent has priority over a competing non-acquisition security right created by the grantor. For this rule to apply, the secured creditor must have possession of the equipment or register a notice with respect to the acquisition security right in the Registry before the expiry of a short time period to be specified by the enacting State (e.g. 15-20 days). This time period starts after either the grantor obtains possession of the equipment or the agreement for the lease or licence of the intellectual property is concluded. If these conditions are met, the acquisition security right will have super-priority over a competing non-acquisition security right. This would be the case even if notice of the non-acquisition security right had been registered or the non-acquisition security right had been made effective against third parties before the acquisition security right (this could happen, for example, where the prior security right covered future assets). Even though possession of the equipment by the secured creditor is an alternative to timely registration for the purposes of obtaining super priority, continued possession of the equipment by the secured creditor is unlikely to be used in practice as a basis for super-priority, as this would deprive the grantor of the use of the equipment in its business. It is likely that possession will be relied on in practice only during the gap between the conclusion of the security agreement and the time when the equipment is delivered to the grantor.

324. Under the super-priority rule in paragraph 2 of option A, additional requirements must be satisfied for an acquisition security right in inventory or its intellectual property equivalent to have “super-priority” over a competing non-acquisition security right. The acquisition security right will have priority if the secured creditor has possession of the inventory, or if two conditions are met before the grantor takes possession (in the case of inventory) or the agreement for sale or licence has been concluded (in the case of the intellectual property equivalent). First, a notice with respect to the acquisition security right must be registered in the Registry. Second, a non-acquisition secured creditor that registered a notice with respect to encumbered assets of the same kind as the inventory (or its intellectual property equivalent) must have received a notice from the acquisition secured creditor. The notice must: (a) state that the acquisition secured creditor has or intends to acquire an acquisition security right; and (b) describe the relevant encumbered assets sufficiently to enable them to be reasonably identified. It should be noted that there is no grace period as in the case of equipment. In addition, even though possession of inventory by the secured creditor is an alternative to the satisfaction of these two conditions for the purposes of obtaining super-priority, a secured creditor is unlikely to rely on its continued possession of inventory as a basis for super-priority, as this would deprive the grantor of the ability to sell the inventory in the course of its business. It is likely that possession will be relied on in practice only during the gap between the conclusion of the security agreement and the time when the inventory is delivered to the grantor.

325. There are two reasons for the different requirements for super-priority in the case of inventory or its intellectual property equivalent as compared to the conditions for super-priority in the case of equipment and its intellectual property equivalent. First, because inventory may “turn over” (i.e. be sold by the grantor) quickly and depreciate quickly, it would be inefficient for a financier extending credit that is intended to be secured by a non-acquisition security right in present and future inventory to have to wait for the expiry of a grace period before being certain that the grantor’s inventory is not subject to an acquisition security right that will have super-priority. The requirement in paragraph 2 that the notice be registered before the grantor obtains possession of the encumbered asset addresses this concern. Second, new inventory can often be difficult to distinguish from old inventory. Thus, even a secured creditor with a non-acquisition security right in future inventory that monitors the ongoing acquisition of inventory by the grantor will not always be able to determine easily that new inventory has replaced similar older inventory and may thus potentially be subject to an acquisition security right. The requirement that the acquisition secured creditor give advance notice to prior-registered non-acquisition secured creditors of its pending acquisition security right addresses this concern.

326. To facilitate acquisition financing, paragraph 4 of option A contains two important clarifications about the advance notice to be sent to prior-registered non-acquisition secured creditors under paragraph 2 (b)(ii). First, the notice may cover acquisition security rights under multiple transactions between the same parties without the need to send a new notice in relation to each new transaction. Thus, for example, where a seller or lender is planning to engage in an ongoing series of financing arrangements with the grantor, a single notice is sufficient, if it sufficiently describes the assets to be covered by these ongoing transactions to enable them to be reasonably identified. Second, the notice, however, will be effective only in respect of encumbered assets that are acquired by the grantor before the expiry of a certain time period to be specified by the enacting State (e.g. five years), after that notice is received by the non-acquisition secured creditor. As a result, an acquisition secured creditor will need to send a new notice before the expiry of the specified time period if it wants to continue thereafter to enjoy the super-priority for its acquisition financing to the grantor.

327. Under the super-priority rule in paragraph 3 of option A, an acquisition security right in consumer goods or their intellectual property equivalent automatically has priority over a non-acquisition security right that is created by the grantor in the same encumbered asset even if the latter was made effective against third parties before the acquisition security right. As with all the rules in article 38, it is implicit that the acquisition security right will only benefit from super-priority if it is effective against third parties. This means, for example, that a security right in consumer goods, other than low-value consumer goods, will need to be made

effective against third parties by registration or possession (see arts. 18 and 24). Once it becomes effective against third parties, the acquisition security right will have priority. A non-acquisition security right may have priority, however, if the acquisition secured creditor fails to register notice of its security right altogether (unless the low-value exemption in art. 24 applies; see para. 128 above).

328. Option B contains only two “super-priority” rules. The rule in paragraph 1 is identical to the rule in paragraph 1 of option A, except that, while paragraph 1 of option A applies only to acquisition security rights in equipment and its intellectual property equivalent, paragraph 1 of option B also applies to acquisition security rights in inventory and the intellectual property equivalent of inventory. The rule in paragraph 2 is identical to the rule in paragraph 3 of option A. Thus, the only difference between option A and option B relates to the steps that must be taken in order for an acquisition security right in inventory or in its intellectual property equivalent to have priority over a competing non-acquisition security right. Under the approach in option B, a non-acquisition secured creditor with a security right in future inventory of the grantor or its intellectual property equivalent will need to monitor the registry record. This will be important if that secured creditor wants to ensure, before extending new credit against new inventory or new intellectual property acquired by the grantor, that it is not the subject of an intervening acquisition security right, which, if registered before the expiry of the specified grace period, will have super-priority. The approach in option A relieves the prior non-acquisition secured creditor from this monitoring burden, but imposes a more onerous registration and notification burden on the acquisition secured creditor.

329. The reference to possession by the secured creditor in paragraphs 1 (a) and 2 (a) of option A and paragraph 1 (a) of option B refers to the situation where the secured creditor has possession of the encumbered asset at the outset of the acquisition financing transaction, such as where the secured creditor is a seller or lessor. It does not refer to possession acquired by the secured creditor as a result of seizure in the context of enforcement upon the grantor’s default. Thus, an acquisition secured creditor that failed to register in time after the grantor obtained possession of the encumbered asset cannot obtain super-priority under this article by subsequently taking possession of the encumbered asset in the context of enforcement or otherwise. Otherwise, an acquisition secured creditor could change its priority by commencing enforcement, a result that would introduce great uncertainty.

Article 39. Competing acquisition security rights

330. Article 39 is based on recommendation 182 of the Secured Transactions Guide (see chap. IX, paras. 173-178). It addresses priority competitions between

acquisition security rights that are created by the same grantor in the same encumbered asset. This type of priority competition could occur in two situations. The first is where two lenders have each financed a part of the total acquisition price of the relevant asset. In this situation, priority is determined under paragraph 1 according to the general rule of priority in article 29 (see paras. 285-294 above). The second situation is where a lender advances part of the acquisition price of the encumbered asset (for example, by lending the money used by the grantor for an advance against the purchase price) with the balance of the acquisition price being financed by the supplier of the encumbered asset. In this second situation, paragraph 2 gives priority to the acquisition security right of the supplier over that of the lender, as long as it is made effective against third parties before the expiry of the period specified in article 38, paragraph 1 (*b*) (see paras. 322 and 323 above).

331. Paragraph 2 protects the supplier over the lender because credit transactions between suppliers and their customers are often entered into on a same day basis without any practical opportunity for the supplier to first check the Registry to determine whether a competing acquisition security right has been registered against the asset. Without being assured of super-priority for a limited period going forward, suppliers would be reluctant to extend secured credit to their customers and this in turn would mean that their customers would be denied access to this important alternative source of secured credit. It should be noted that this rule applies even where the encumbered asset is inventory or its intellectual property equivalent. This is so notwithstanding that, under paragraph 2 of option A, the secured creditor must register and give notice to prior-registered non-acquisition secured creditors before the grantor obtains possession of inventory or the agreement for the sale or licence of the intellectual property equivalent of inventory is concluded in order to obtain super-priority against the holder of a prior non-acquisition security right in the encumbered asset.

Article 40. Acquisition security rights competing with the rights of judgment creditors

332. Article 40 is based on recommendation 183 of the Secured Transactions Guide (see chap. IX, paras. 145-148). It provides that an acquisition security right that is made effective against third parties before the expiry of the period specified in article 38, subparagraph 1 (*b*) has priority over the rights of a judgment creditor that would otherwise have priority under article 37. Where the enacting State adopts option B of article 38, article 40 ensures that acquisition secured creditors enjoy the same grace period to preserve priority over the rights of intervening judgment creditors as is available to them to establish priority over the rights of non-acquisition secured creditors.

333. By way of illustration, assume that Grantor acquires an item of equipment from Seller on credit on Day 1 and creates in favour of Seller an acquisition security right in the item of equipment to secure its obligation to pay the balance of the purchase price. On Day 5 Seller registers a notice. In the meantime, on Day 3, Judgment Creditor obtains a judgment against Grantor and takes the steps specified in article 37, paragraph 1, to acquire rights in the item of equipment. Under the rule in article 37, paragraph 1, Judgment Creditor's rights would have priority over Seller's security right because Judgment Creditor obtained its rights before Seller's security right was made effective against third parties by registration of a notice. As a result of the operation of article 40, however, Seller's security right has priority over the rights of Judgment Creditor.

334. Where the acquisition security right covers inventory and the enacting State adopts option A of article 38, the rationale for the rule in article 40 is necessarily different. This is so because paragraph 2 of option A of article 38 requires the acquisition secured creditor to register before the grantor obtains possession of inventory (or the agreement for the sale or licence of the intellectual property equivalent of inventory is concluded) in order to obtain super-priority against the holder of a prior non-acquisition security right. The rationale for giving superior protection against judgment creditors in this situation is the same as that which informs the priority rule in article 39. Acquisition financing is often provided by suppliers (as opposed to lenders), and supplier financing is often concluded on a same-day basis. Thus, article 40 ensures that suppliers are not prevented in practice from entering into inventory financing arrangements for fear that a judgment creditor may in the coming days take the steps necessary to acquire rights in the relevant inventory so as to obtain priority under article 37.

Article 41. Competing security rights in proceeds of an asset subject to an acquisition security right

335. Article 41 is based on recommendation 185 of the Secured Transactions Guide (see chap. IX, paras. 158-172). Both option A and option B of article 38 provide that, if the specified conditions are satisfied, an acquisition security right has priority over a competing non-acquisition security right in the same encumbered asset even if the non-acquisition security right would have priority under the general priority rule in article 29. Article 41 determines whether that "super-priority" carries over to proceeds of the encumbered assets that are subject to the acquisition security right.

336. Under article 10, a secured creditor with a security right in an asset automatically has a security right in the identifiable proceeds of that asset; and, under article 19, that security right is effective against third parties if the conditions

specified in that article are satisfied. Under article 32, the priority of a security right in proceeds that is effective against third parties under article 19 is the same as the priority of the security right in the original encumbered asset. Under this rule, a security right in proceeds of assets subject to an acquisition security right would have the same “super-priority” as the security right in the original encumbered asset. Article 41, however, limits the application of article 32 by restricting the “super-priority” to the proceeds of only certain types of asset subject to an acquisition security right (option A) or by not extending the “super-priority” to the proceeds at all (option B).

337. Paragraph 1 of option A provides that the “super-priority” of an acquisition security right under article 38 generally carries over to the proceeds of those assets. This is subject, however, to the exception in paragraph 2 for proceeds of inventory or its intellectual property equivalent. Under subparagraph 2 (a), the “super-priority” does not carry over to proceeds of inventory or its intellectual property equivalent that is in the form of receivables, negotiable instruments or rights to payment of funds credited to a bank account. If the proceeds take any other form, subparagraph 2 (b) provides that the acquisition security right in the proceeds will have “super-priority” if, before the proceeds arose, the non-acquisition secured creditor had previously registered a notice in the Registry with respect to a security right in an asset of the same kind as the proceeds and the non-acquisition secured creditor receives a notice from the acquisition secured creditor that states that it has or intends to obtain a security right in assets of that kind and that describes those assets sufficiently to enable them to be identified.

338. The reason why subparagraph 2 (a) does not to extend “super-priority” to proceeds of inventory (and its intellectual property equivalent) that take the form of receivables, negotiable instruments or rights to payment of funds credited to a bank account relates to the difficulty that would otherwise be faced by prior non-acquisition secured creditors with security rights in these types of assets as original encumbered assets. If the “super-priority” given to acquisition security rights were extended to those types of proceeds, potential secured creditors would be reluctant to extend credit on the basis of these types of assets as original encumbered assets for fear that their priority would be trumped by the security right of subsequent acquisition financiers in these types of assets as proceeds. The reason why subparagraph 2 (b) requires the acquisition secured creditor to send a notice to prior-registered non-acquisition secured creditors with a security right in the same kind of assets as the proceeds where the proceeds take any other form is to alert them to the existence of its prior-ranking security right in this kind of assets as proceeds so that they can decide whether to extend further credit to the grantor on the security of those assets. The decision not to provide “super-priority” with respect to these payment rights reflects a policy decision to promote receivables financing and other forms of financing based upon such payment rights.

339. Option B provides that the “super-priority” with respect to assets subject to an acquisition security right does not carry over to proceeds of those assets under any circumstances. Instead, the priority of the security right in the proceeds will be determined under the general priority rules in article 29. Option B avoids the need to make the sort of distinctions between types of proceeds required to be made in option A.

340. As already explained (see para. 296 above), article 35 provides that a security right that is effective against third parties remains effective against third parties and retains the priority it had against competing claimants notwithstanding the commencement of insolvency proceedings by or against the grantor except to the extent that the enacting State’s insolvency law provides otherwise. Article 35 applies equally to the special priority accorded to acquisition security rights (see Secured Transactions Guide, rec. 186).

Article 42. Acquisition security rights extending to a mass or product competing with non-acquisition security rights in the mass or product

341. Article 42 preserves the super-priority of an acquisition security right in an asset that later becomes part of a mass or product in a way that allows the acquisition security right to extend to the mass or product under article 11 as against a competing non-acquisition security right in the mass or product as an original encumbered asset. Article 42 is subject to article 38, meaning that the super-priority of the acquisition security right is conditional on compliance with the conditions for super-priority set out in that article.

Article 43. Subordination

342. Article 43 is based on recommendation 94 of the Secured Transactions Guide (see chap. V, paras. 128-131). Paragraph 1 allows a person to subordinate its security right to a competing claim over which it would otherwise have priority. Such subordination may take the form of a bilateral agreement between the party agreeing to subordinate its security right and the competing claimant that will benefit from that subordination. However, paragraph 1 provides that the beneficiary need not be a party to the subordination. Thus, the subordination may also take the form of a unilateral commitment (usually made to the grantor) by the party agreeing to a lower priority that it will not assert its priority against a specified competing claimant or a specified class of competing claimants.

343. Paragraph 2 makes it clear that subordination does not affect the rights of competing claimants other than the party agreeing to subordinate its priority and

the beneficiary of that agreement. For example, assume that three secured creditors, SC 1, SC 2 and SC 3, have security rights in the same encumbered assets, securing claims of €50, €10 and €70, respectively. Assume further that the order of priority (highest to lowest) is SC 1, SC 2 and SC 3, and that SC 1 subordinates its claim to that of SC 3. Under the rule in paragraph 2, the effect of the subordination is that SC 3 will succeed to SC 1's priority status up to €50 and that SC 2's claim to the next €10 will not be affected.

Article 44. Future advances and future encumbered assets

344. Article 44 is based on recommendations 97-99 of the Secured Transactions Guide (see chap. V, paras. 135-143). It clarifies the operation of the priority rules in this chapter in relation to a security right that secures obligations arising after the conclusion of the security agreement (see art. 7) and in relation to encumbered assets that come into existence or are acquired by the grantor after the conclusion of the security agreement.

345. Paragraph 1 provides that the priority of a security right extends to all obligations it secures, regardless of when those obligations were incurred. Thus, a security right has the same priority over the right of a competing claimant whether the entire secured obligation was incurred at or before the creation of the security right or all or a portion of the secured obligation was incurred thereafter. This rule is subject, however, to the rule in article 37, under which a judgment creditor may have priority for advances made by the secured creditor after it has knowledge that the judgment creditor has taken the steps necessary to acquire rights in the encumbered asset and has had a short period of time (set out in art. 37) to adjust. This rule is also subject to the maximum sum specified in the registered notice should the enacting State decide to require a maximum sum to be set out in the security agreement and in the registered notice.

346. Paragraph 2 similarly provides that, when a security right has been made effective against third parties by the registration of a notice, the priority resulting from that registration under article 29 extends to all the encumbered assets described in the notice whether they were owned by the grantor at the time of registration or were acquired thereafter.

Article 45. Irrelevance of knowledge of the existence of a security right

347. Article 45 is based on recommendation 93 of the Secured Transactions Guide (see chap. V, paras. 125-127). It confirms that a secured creditor's knowledge or lack

of knowledge of the existence of a competing security right at the time it acquired its own security right is not relevant to the operation of the priority rules in this chapter. The point is made explicit to emphasize that priority is determined only on the basis of those priority rules and that difficult-to-prove subjective states of knowledge are irrelevant. Article 45 applies only to a secured creditor's knowledge of the existence of a competing security right. Under the Model Law, however, knowledge of facts relating to the security right may be relevant in other contexts. For example, a buyer of a tangible encumbered asset sold in the ordinary course of the grantor's business that has knowledge that the particular sale breaches the rights of the secured creditor under its security agreement with the grantor does not take free of the security right; on the other hand, mere knowledge of the existence of the security right does not disqualify the buyer from protection (see art. 34, para. 4).

B. Asset-specific rules

Article 46. Negotiable instruments

348. Article 46 is based on recommendations 101 and 102 of the Secured Transactions Guide (see chap. V, paras. 154-156). Differences between article 46 and recommendations 101 and 102 are of a drafting nature only. Paragraph 1 deals with the priority between competing security rights in the same negotiable instrument. Paragraph 2 addresses the rights of a secured creditor with a security right in a negotiable instrument as against a buyer or other consensual transferee of the negotiable instrument.

349. Under paragraph 1, a security right in a negotiable instrument that is made effective against third parties by the secured creditor's possession of the negotiable instrument has priority over a security right in the same negotiable instrument that is made effective against third parties by registration of a notice, whether the secured creditor took possession before or after the notice was registered. This is consistent with the important role that possession plays in ensuring negotiability under the law relating to negotiable instruments.

350. Paragraph 2 provides similar protection to a buyer or other consensual transferee that obtains possession of a negotiable instrument as against a secured creditor with a security right in the instrument that was made effective against third parties by registration of a notice. First, under paragraph 2 (a), the buyer or other consensual transferee acquires its rights free of the security right if it qualifies as a protected holder or the like under the law relating to negotiable instruments (the enacting State should insert the appropriate term in para. 2 (a)). Second, under paragraph 2 (b), a buyer or other transferee that takes possession of the instrument and gives value for it without knowledge that the sale or other transfer violates the rights of the secured creditor under the security agreement also acquires its right

in the instrument free of that security right. As with the rule in paragraph 1, this rule preserves the important role of possession in ensuring negotiability under the law relating to negotiable instruments.

351. Knowledge of the existence of a security right does not prevent a buyer or other consensual transferee of a negotiable instrument from acquiring its rights in the instrument free of the security right under paragraph 2 (b) (although such knowledge may prevent the buyer or other transferee from qualifying as a protected holder or the like and, thus, may prevent the buyer or other transferee from taking free of the security right under paragraph 2 (a)). Rather, only knowledge that the sale or other transfer violates the rights of the secured creditor under the security agreement prevents the buyer or other transferee from acquiring its rights in the instrument free of the security right under paragraph 2 (b). “Knowledge”, as defined in article 2, subparagraph (r), means “actual knowledge”. The reference to “good faith” that was included in recommendation 102 (b) of the Secured Transactions Guide has been deleted on the understanding that the absence of knowledge amounts essentially to good faith in this context (and because the concept of good faith is used in the Model Law only to reflect an objective standard of conduct).

Article 47. Rights to payment of funds credited to a bank account

352. Article 47 is based on recommendations 103-105 of the Secured Transactions Guide (see chap. V, paras. 157-163). It determines priority between competing security rights in a right to payment of funds credited to a bank account whether those rights to payment are original encumbered assets or are proceeds of a security right in other property. In this respect, it should be noted that, according to article 19, paragraph 1, a security right in proceeds in the form of a right to payment of funds credited to a bank account is automatically effective against third parties if the security right in the original encumbered asset is effective against third parties. Article 47 provides for special priority rules because a security right in a right to payment of funds credited to a bank account may be made effective against third parties by methods other than registration (e.g. by control). Thus, there is a particular need to address priority competitions between security rights to payment of funds credited to a bank account made effective against third parties by different methods (see Secured Transactions Guide, chap. V, para. 157).

353. Paragraphs 1-3, taken together, have the effect that a security right in a right to payment of funds credited to a bank account that is made effective against third parties by any of the methods provided for in article 25 has priority over a security right that is made effective against third parties by registration of a notice in the Registry under article 18. Under paragraph 1, a security right in a right to payment of funds credited to a bank account that is made effective against third parties by

the secured creditor becoming the account holder has priority over all competing security rights in the same asset. Next in the order of priority, under paragraphs 2 and 3 are: (a) a security right created in favour of the deposit-taking institution; and (b) a security right made effective against third parties by the conclusion of a control agreement between the secured creditor, the grantor and the deposit-taking institution (for the definition of the term “control agreement”, see art. 2, subpara. (g) (ii)). Under paragraph 4, priority between competing security rights created in favour of secured creditors who have all concluded a control agreement is determined by the order of conclusion of the control agreements. This approach facilitates secured transactions that rely specifically on rights to payment of funds credited to a bank account by relieving secured creditors that make their security rights effective against third parties under article 25 from the general obligation of searching the Registry and from the first-to-register priority rules in article 29 (see Secured Transactions Guide, chap. V, para. 158).

354. Under paragraph 5, except when the secured creditor has become the account holder, a security right in a right to payment of funds credited to a bank account is subordinate to the deposit-taking institution’s right under other law to set off its claims against the grantor against its obligation to the grantor with respect to the grantor’s right to payment of funds from the bank account. The effect of this rule is to preserve the right of a deposit-taking institution to exercise its right of set-off that it has under other law.

355. Under paragraph 6, a transferee of funds from a bank account pursuant to a transfer initiated or authorized by the grantor acquires its rights free of a security right in the right to payment of funds credited to the bank account so long as the transferee does not have knowledge that the transfer violates the rights of the secured creditor under the security agreement. A “transfer of funds” includes transfers by a variety of mechanisms, including by cheque and electronic means. The purpose of paragraph 6 is to preserve the free negotiability of funds.

356. Knowledge of the existence of a security right does not prevent a transferee of funds from a bank account from taking free of the security right. Rather, it is only knowledge that the transfer violates the rights of the secured creditor under the security agreement that prevents the transferee from taking free. “Knowledge”, as defined in article 2, paragraph (r), means “actual knowledge”. Paragraph 7 also preserves the rights of transferees of funds credited to a bank account under any other law specified by the enacting State.

Article 48. Money

357. Article 48 is based on recommendation 106 of the Secured Transactions Guide (see chap. V, para. 164). Its purpose is to preserve the negotiability of money.

Thus, under paragraph 1, a transferee of encumbered money acquires its rights in the money free of the security right, unless it has knowledge that the transfer violates the rights of the secured creditor under the security agreement. “Knowledge”, as defined in article 2, paragraph (*r*), means “actual knowledge”. Paragraph 2 also preserves the rights of persons in possession of money under any other law specified by the enacting State.

Article 49. Negotiable documents and tangible assets covered by negotiable documents

358. Article 49 is based on recommendations 108 and 109 of the Secured Transactions Guide (see chap. V, paras. 167-169). It is intended to preserve the widely recognized practice under which rights to tangible assets that are covered (or represented) by a negotiable document are subsumed in the negotiable document with the result that persons that acquire rights in the document thereby also acquire rights in the assets covered by the document. Accordingly, under paragraph 1, a security right in a tangible asset that is made effective against third parties by possession of the negotiable document covering that asset has priority over a competing security right in the tangible asset that is made effective against third parties by any other means.

359. Paragraph 2 states an exception to that general rule. Except when the encumbered asset is inventory, it provides that the rule in paragraph 1 does not apply to a security right in a tangible asset that is made effective against third parties before the earlier of: (*a*) the time when that asset became covered by the negotiable document; or (*b*) the time of conclusion of the agreement between the grantor and the secured creditor in possession of the negotiable document so long as the asset actually became covered by the negotiable document before the expiry of a short period of time thereafter to be specified by the enacting State (e.g. seven days).

Article 50. Intellectual property

360. Article 50 is based on recommendation 245 of the Intellectual Property Supplement (see paras. 193-212). Its purpose is to clarify that the rule in article 34, paragraph 6, does not affect other rights of the secured creditor in its capacity as an owner or licensor of the intellectual property that is the subject of the licence under other law relating to intellectual property to be specified by the enacting State. For example, the Model Law does not affect any right that a licensor may have to terminate a licence agreement for non-compliance by the licensee (see Intellectual Property Supplement, paras. 23-25 and 196). This clarification is of particular importance because the concept of “ordinary course of business”, used in article 34, paragraph 6, is a concept of commercial law and is not drawn from

law relating to intellectual property and thus may create confusion in an intellectual property context. The concept of “ordinary course of business” is not germane to law relating to intellectual property, which instead focuses on whether a licence has been authorized. Like any other provision of the Model Law that deals with security rights in intellectual property, article 50 does not apply in so far as it is inconsistent with the law of the enacting State relating to intellectual property (see art. 1, para. 3 (b), and Intellectual Property Supplement, para. 203).

361. As a result, depending on the content of law relating to intellectual property, unless the secured creditor authorized the grantor to grant licences unaffected by the security right, the licensee may only take the licence subject to the security right, rather than free of it. This would mean that, if the grantor defaults, the secured creditor would be able to enforce its security right in the licensed intellectual property and sell or license it free of the licence. As a consequence, a person obtaining a security right from the licensee will only obtain a security right of limited value, as the encumbered licensed intellectual property may cease to exist if the licensor’s secured creditor enforces its security right (following default by the licensor under its security agreement with the secured creditor).

Article 51. Non-intermediated securities

362. Article 51 covers security rights in non-intermediated securities. This is a type of encumbered asset not addressed in the Secured Transactions Guide, which excluded from its scope security rights in all types of securities (see rec. 4 (c)). Article 51 adjusts the general priority rules in article 29 in a manner similar to the special priority rules for security rights in negotiable instruments (for certificated securities) and rights to payment of funds credited to a bank account (for uncertificated securities).

363. For certificated non-intermediated securities, paragraph 1 provides that a security right that is made effective against third parties by the secured creditor’s possession of the certificate has priority over a competing security right created by the same grantor that is made effective against third parties by registration of a notice in the Registry. This parallels the rule for negotiable instruments in article 46, paragraph 1 and similarly reflects the negotiable character of this type of encumbered asset (the term “certificated non-intermediated securities” is defined in art. 2, para. (d), in a manner that reflects its negotiable character).

364. For uncertificated non-intermediated securities, paragraph 2 provides that a security right that is made effective against third parties by an entry in the books maintained for that purpose by or on behalf of the issuer has priority over a security right in the same securities that is made effective against third parties by any other

method (i.e. by registration of a notice in the Registry or by the conclusion of a control agreement). Depending on the law of the enacting State, the entry in the books of the issuer may take the form of a notation of the security right or an entry of the name of the secured creditor as the holder of the securities. The enacting State should specify the form of entry in the books of the issuer that best fits its law. If that law provides for both forms of entry in the books of the issuer, both could be retained. This priority rule is similar to the rule for rights to payment of funds credited to a bank account in article 47, paragraph 1. The rationale for this rule is that such entry in the books of the issuer fulfils a function similar to the secured creditor becoming the account holder of a bank account.

365. The priority rules in paragraphs 3 and 4 also apply only to uncertificated non-intermediated securities. They parallel the rules for security rights in rights to payment of funds credited to a bank account in article 47, paragraphs 3 and 4. Paragraph 3 gives priority to a security right that is made effective against third parties by the conclusion of a control agreement over a competing security right in the same securities made effective against third parties by registration of a notice in the Registry. As between competing security rights made effective against third parties by the conclusion of a control agreement, paragraph 4 awards priority in the order in which the control agreements were concluded (for the definition of the term “control agreement, see art. 2, subpara. (g)(i)).

366. Unlike article 46, paragraph 2, article 47, paragraph 6, and article 49, paragraph 3, which provide a priority rule protecting transferees under other law, paragraph 5 does not include a priority rule but instead defers to the law relating to the transfer of securities to be specified by the enacting State. The reason for this approach is that national law diverges widely with respect to the protection of holders of non-intermediated securities and the matter does not lend itself to unification at the international level. It should be noted that, if the enacting State neither has nor is prepared to introduce a law relating to the transfer of securities, it may not need to implement paragraph 5.

Chapter VI. Rights and obligations of the parties and third-party obligors

367. Section I of chapter VI deals with the mutual rights and obligations of the parties to the security agreement before or after default (while chapter VII deals with their post-default rights and obligations). Section II of chapter VI deals with the rights and obligations of third-party obligors.

368. With the exception of articles 53 and 54 which are mandatory rules, the provisions of section I of chapter VI are non-mandatory, and thus do not apply if the parties to the security agreement have agreed otherwise (see art. 3, para. 1, and para. 73 above). The provisions of section II of chapter VI are also non-mandatory. However, an agreement between the grantor and the secured creditor to modify any of its provisions does not affect the rights and obligations of the debtor of the receivable or other third-party obligor, unless it consents. It should also be noted that the creation of a security right does not change the rights and obligations of the debtor of the receivable, except as otherwise provided in the Model Law (see art. 61, para. 1, and para. 376 below).

Section I. Mutual rights and obligations of the parties to a security agreement

A. General rules

Article 52. Sources of mutual rights and obligations of the parties

369. Article 52 is based on recommendation 110 of the Secured Transactions Guide (see chap. VI, paras. 14 and 15), which in turn is based on article 11 of the Assignment Convention. Paragraph 1 is intended to reiterate the principle of party autonomy enshrined in article 3. Paragraph 2 is intended to give legislative strength to trade usages and practices, which may not be generally recognized in all States.

Article 53. Obligation of the party in possession to exercise reasonable care

370. Article 53 is based on recommendation 111 of the Secured Transactions Guide (see chap. VI, paras. 24-31). It sets out the mandatory rule (see para. 368 above) that a grantor or secured creditor in possession of a tangible asset (which under the definition in art. 2, subpara. (II), includes money, negotiable instruments, negotiable documents and certificated non-intermediated securities) must exercise reasonable care to preserve the asset. Whether a person other than the grantor and the secured creditor that is in possession of an encumbered asset is obliged to take reasonable care to preserve the encumbered asset is determined under other law.

371. What constitutes “reasonable care” in a given case depends upon the nature of an asset. Thus, it may mean something different with respect to equipment, inventory, crops or live animals. For example, precious metals may have to be kept in a vault and inventory in a warehouse, a cow has to be milked, a valuable musical instrument has to be played and a racehorse has to exercise. According to article 4, a person must exercise its rights and perform its obligations, including the obligation to preserve the value of the asset, in good faith and in a commercially reasonable manner.

372. Unlike recommendation 111 of the Secured Transactions Guide, on which it is based, article 53 refers only to the preservation of the asset, and not to the preservation of the asset’s value. This does not reflect a change of policy but is, rather, due to the fact that: (a) in most cases, physical preservation of a tangible asset would have the effect of preserving the asset’s value; and (b) in other cases, preservation of the asset’s value may go beyond the physical preservation of the asset but should not impose an undue burden on the person in possession. For example, a person in possession of certificated non-intermediated shares of a company may be required in particular circumstances to exercise certain rights attached to the shares (e.g. the right to collect dividends or the right to vote), but should not be obliged to participate in an increase of the capital of an enterprise to preserve the value of the encumbered shares.

Article 54. Obligation of the secured creditor to return an encumbered asset

373. Article 54 is based on recommendations 112 and 72 of the Secured Transactions Guide (see chap. VI, paras. 35-39). It sets out a mandatory rule (see para. 368 above) that, once a security right in an encumbered asset is extinguished, a secured creditor in possession of the asset must return it to the grantor or deliver it to a person designated by the grantor (in some jurisdictions, delivery to a person

designated by the grantor may be viewed as a means of returning the asset to the grantor). Under article 4, the grantor would be obliged to exercise the right to designate another person in good faith and in a commercially reasonable manner (e.g. by avoiding placing an undue burden on the secured creditor). Any cost incurred by the secured creditor to return the asset is normally borne by the grantor in the same way as the costs of performance of the grantor's obligation under the security agreement are normally payable by the grantor. However, the allocation of costs is a matter of party autonomy and the parties may agree otherwise.

374. Where a security right in an encumbered asset is extinguished, and the security right had been made effective against third parties, not by possession, but by registration, the secured creditor is obliged to register an amendment or cancellation notice. This issue is addressed in article 20, paragraphs 1, 2 and 3 of the Model Registry Provisions (see paras. 211-214 above). The question of when a security right is extinguished is addressed in article 12 of the Model Law (see paras. 107 and 108 above).

375. Article 54 deals with a situation in which the secured creditor is in possession of an asset and therefore does not apply to receivables or other intangible assets because they cannot be the subject of physical possession (see art. 2, subpara. (z), and para. 56 above). It therefore does not address the obligation of a secured creditor to withdraw any notification that it has given to the debtor of the receivable. However, the grantor is protected in this situation by article 59, paragraph 2, and article 79, paragraph 2 (b), which require the secured creditor to return to the grantor any surplus proceeds it receives (see paras. 390 and 451 below). It should also be noted that the question of whether a secured creditor may agree with the grantor that the secured creditor has the right to dispose of encumbered non-intermediated securities and thus be obliged to return equivalent securities is a matter for other law.

Article 55. Right of the secured creditor to use and inspect an encumbered asset, and to be reimbursed for expenses

376. Article 55 is based on recommendation 113 of the Secured Transactions Guide (see chap. VI, paras. 50-65) and sets out a rule, which the parties may vary or derogate from by agreement (see para. 368 above). Under paragraph 1 (a), a secured creditor in possession of an encumbered asset has the right to be reimbursed for reasonable expenses incurred to preserve it in accordance with article 53. Under paragraph 1 (b), a secured creditor in possession of an encumbered asset may make reasonable use of it and apply any revenues generated from the use to the payment of the obligation secured by the asset.

377. It should be noted that article 55 is consistent with laws relating to securities that permit a secured creditor to use securities in its possession if the security agreement so provides.

378. Finally, under paragraph 2, where an encumbered asset is in the possession of the grantor, the secured creditor has the right to inspect the asset. As this article is subject to the general standard of commercial reasonableness and good faith set out in article 4, the right to inspect may only be exercised at reasonable times and in a commercially reasonable manner. The application of this standard depends upon the circumstances. For example, in extreme cases, such as where the secured creditor has reason to believe that the physical condition of the collateral is in jeopardy or has been, or is about to be, removed from the State of its location, the secured creditor may be justified in demanding an immediate inspection.

Article 56. Right of the grantor to obtain information

379. Article 56 is intended to provide the grantor with the right to obtain information from a secured creditor as to the amount of the secured obligation or as to the assets encumbered at a certain point of time. This information may be necessary where the grantor is interested in obtaining credit against the security of assets that are already encumbered and the potential third-party creditor requests that information. The parties may vary or derogate from the rule set out in article 56 (see para. 368 above).

380. Under paragraph 1, the secured creditor is obliged to provide this information within a short time period specified by the enacting State (e.g. 7 to 14 days) after receipt of the grantor's request. This obligation does not apply to an outright transfer of receivables by agreement, because in the case of an outright transfer there is no secured obligation.

381. Under paragraph 2, the grantor is entitled to one response free of charge during a short period of time specified by the enacting State (e.g. one year). Under paragraph 3, the secured creditor is entitled to require payment of a nominal fee for any additional response. The grantor should exercise this right and the secured creditor should perform this obligation in good faith and in a commercially reasonable manner (e.g. the grantor should avoid repeated and unnecessary requests, and the secured creditor should provide the information in a way that can be readily understood). Other matters, such as the legal consequences of the secured creditor's failure to comply with a request for information or to give accurate information are left to other law (in the same way as breach of any of other obligations in this chapter is left to other law). The enacting State may wish to consider the question whether third-party creditors (e.g. judgment creditors) should also be given this right to information.

B. Asset-specific rules

Article 57. Representations of the grantor of a security right in a receivable

382. Article 57 is based on recommendation 114 of the Secured Transactions Guide (see chap. VI, para. 73), which in turn is based on article 12 of the Assignment Convention. It provides that, unless otherwise agreed (see para. 368 above), when a grantor grants a security right in a receivable, the grantor is deemed to make various representations to the secured creditor at the time the security agreement is concluded. In particular, under paragraph 1, the grantor represents that it has not previously created a security right in the receivable in favour of another secured creditor, and that the debtor of the receivable will not have any defences or rights of set-off with respect to the receivable (i.e. that the grantor will fully perform the contract giving rise to the receivable and any other contract it has entered into with the debtor of the receivable).

383. Paragraph 2 reflects the generally accepted principle that, unless otherwise agreed (see para. 368 above), the grantor does not guarantee the solvency of the debtor of the receivable. As a result, the risk of debtor default is on the secured creditor, a fact that the secured creditor will take into account in determining whether to extend credit and on what conditions. However, the parties to financing transactions may agree on a different risk allocation. Such an agreement may refer to the solvency of the debtor of the receivable at the time when the security agreement is entered or at the time when the receivable will become payable.

384. The representation that the grantor has the right to create a security right was not carried over from recommendation 114 of the Secured Transactions Guide into article 57, to avoid giving the impression that it applies only to security rights in receivables. As a result, the matter is left to general law. It should be noted, however, that even where an anti-assignment clause is included in the contract giving rise to the receivable or other agreement between a grantor and the debtor of the receivable, the grantor still has rights in the receivable or the power to encumber it, and thus may create an effective security right in the receivable (see arts. 6, para. 1, and art. 13, para. 1, and paras. 83 and 109 above).

Article 58. Right of the grantor or the secured creditor to notify the debtor of the receivable

385. Article 58 is based on recommendation 115 of the Secured Transactions Guide (see chap. VI, paras. 74 and 75), which in turn is based on article 13 of the Assignment Convention. It sets out a rule, which the parties may vary or derogate

from by agreement (see para. 368 above). Paragraph 1 provides that, when a security right has been created in a receivable, either the grantor or the secured creditor has the right to notify the debtor of the receivable of the existence of the security right and send a payment instruction; however, once notification of the security right has been received by the debtor of the receivable, only the secured creditor may send a payment instruction. It should be noted that, under article 62, a notification or a payment instruction is effective only when received by the debtor of the receivable.

386. While they may be included in the same document, a payment instruction is conceptually distinct from a notification. A payment instruction normally advises the debtor of the receivable how it is to make payment, and a notification typically informs the debtor of the receivable that it owes its obligations to a different person. For example: (a) a notification may contain no payment instruction (e.g. because the secured creditor may have obtained control of the grantor's bank account to which debtors of receivables have been instructed by the grantor to make their payments); (b) the parties may have agreed that only a payment instruction will be given (e.g. because the transaction involved is a non-notification factoring or undisclosed invoice discounting transaction); and (c) the secured creditor may need to change its payment instructions and thus there may be more than one payment instruction.

387. Paragraph 2 provides that a notification sent in breach of an agreement between the grantor and the secured creditor is nevertheless effective for the purposes of article 63. This means that the debtor of the receivable that pays in accordance with that notification is discharged (see paras. 398-405 below). However, article 58 does not affect any obligation or liability that the secured creditor may have under other law for sending a notification to the debtor of the receivable in breach of an agreement with the grantor.

Article 59. Right of the secured creditor to payment of a receivable

388. Article 59 is based upon recommendation 116 of the Secured Transactions Guide (see chap. VI, paras. 76-80), which in turn is based on article 14 of the Assignment Convention. Changes made are intended to clarify the text, and not to change its policy. Article 59, reiterates that a secured creditor with a security right in a receivable has (as against the grantor) the right to receive the proceeds of the encumbered receivable (see art. 10). The parties may vary or derogate from the rule set out in article 59 (see para. 368 above).

389. Paragraph 1 provides that, regardless of whether notification of the security right has been sent to the debtor of the receivable, the secured creditor is entitled

to: (a) retain the proceeds of any full or partial payment of the receivable made to the secured creditor, as well as any tangible assets (such as inventory) returned to the secured creditor in respect of the receivable; (b) payment of the proceeds of any full or partial payment of any receivable made to the grantor (as well as any tangible assets returned to the grantor); and (c) payment of the proceeds of any full or partial payment of any receivable made to another person (as well as any tangible assets returned to that person) if the right of the secured creditor has priority over the right of that person.

390. Paragraph 2 provides that, unless otherwise agreed (see para. 368 above), the secured creditor has the right to collect the full amount of the encumbered receivable, but has to account for and return to the grantor any surplus remaining after payment of the secured obligation (art. 79, para. 2, contains a similar rule). It should be noted that there cannot be any surplus in the case of an outright transfer of a receivable by agreement; the transferee may then retain the full amount collected, as that will be the “value” of its right in the receivable.

Article 60. Right of the secured creditor to preserve encumbered intellectual property

391. Article 60 is based on recommendation 246 of the Intellectual Property Supplement (paras. 223-226). It parallels the rule in article 53 (which is based on rec. 111 of the Secured Transactions Guide and applies only to tangible assets). Under article 60, if so agreed with the grantor, the secured creditor would be entitled to exercise rights that are normally rights of the intellectual property right holder (e.g. to deal with authorities, renew registrations and pursue infringers, even before default, provided that it is not prohibited by law relating to intellectual property). This is important, as, if the grantor (the intellectual property right holder) failed to exercise these rights in a timely fashion, the value of the encumbered intellectual property could diminish, and this could negatively affect the use of intellectual property as security for credit.

Section II. Rights and obligations of third-party obligors

A. Receivables

Article 61. Protection of the debtor of the receivable

392. Article 61 is derived from recommendation 117 of the Secured Transactions Guide (see chap. VII, para. 12), which in turn is based on article 15 of the

Assignment Convention. Paragraph 1 sets out the general principle that the creation of a security right in a receivable does not affect the rights or obligations of the debtor of the receivable, unless the debtor of the receivable consents. So, for example, without the consent of the debtor of the receivable, the creation of a security right cannot change the payment terms of a contract giving rise to a receivable (e.g. the amount or the time of payment), alter the defences or rights of set-off that the debtor of the receivable may raise under the contract giving rise to the receivable or increase expenses in connection with payment of the receivable.

393. Under paragraph 2, a payment instruction (whether given together with the notification or subsequently) may change the person, address or account to which the debtor of the receivable is required to make payment, as these changes do not affect the rights or obligations of the debtor of the receivable. However, a payment instruction may not change: (a) the currency in which the receivable is to be paid, as specified in the contract giving rise to the receivable; or (b) the State in which the payment is to be made, as specified in the contract giving rise to the receivable, to a State other than that in which the debtor of the receivable is located. This is because these changes would affect the debtor's rights and obligations.

394. It should be noted that, unlike the Assignment Convention that includes in article 5, subparagraph (h), a rule of interpretation as to the location of a person for the purposes of the Convention, the definition of "location" in article 90 of the Model Law applies only in the context of chapter VIII on conflict of laws. Thus, for example, the location of the debtor of the receivable referred to in article 61, paragraph 2 (b), should be understood in the light of other law of the enacting State.

Article 62. Notification of a security right in a receivable

395. Article 62 is based on recommendation 118 of the Secured Transactions Guide (see chap. VII, paras. 13-16), which in turn is based on article 16 of the Assignment Convention. It describes the requirements both for an effective notification of a security right in a receivable and for a payment instruction (which is conceptually distinct from a notification, see para. 386 above).

396. Under paragraph 1, a notification or a payment instruction is effective from the time when it is received by the debtor of the receivable, if it reasonably identifies the receivable and the secured creditor, and is in a language reasonably expected to inform the debtor of its contents. On this latter point, paragraph 2 makes it clear that the language of the contract giving rise to the receivable is always sufficient. Under paragraph 3, a notification (which may include a payment instruction or not) may relate not only to receivables in existence at the time the notification is given, but also may relate to receivables arising thereafter.

397. Paragraph 4 addresses a scenario where a receivable is the subject of multiple successive security rights (under art. 2, subpara. (kk), the term “security right” includes outright transfers of receivables). The following example illustrates the operation of paragraph 4. A, to whom a receivable is owed, makes an outright transfer of the receivable to B. B then makes an outright transfer of the receivable to C. C then makes an outright transfer of the receivable to D. Notification to the debtor of the receivable relating to the outright transfer to D will also constitute notification of the prior outright transfers to B and C. The same result would arise if A created a security right in the receivable in favour of B, B then created a security right in the receivable in favour of C, and C thereafter created a security right in the receivable in favour of D. Notification to the debtor of the receivable relating to the security right created by C in favour of D constitutes notification of the security rights created by A and B.

Article 63. Discharge of the debtor of the receivable by payment

398. Article 63 is based on recommendation 119 of the Secured Transactions Guide (see chap. VII, paras. 17-20), which in turn is based on article 17 of the Assignment Convention. It sets out the rules dealing with the discharge of the debtor of the receivable by payment. It should be noted that the debtor of the receivable is discharged by payment in accordance with this article, even if payment is not made to the secured creditor that has priority. It should also be noted that this article and all articles of the Model Law with the exception of articles 72-82 apply also to outright transfers of receivables by agreement (see art. 1, para. 2).

399. Paragraph 1 embodies the basic principle that, until the debtor of the receivable receives notification of a security right in the receivable, it may be discharged by payment in accordance with the contract giving rise to the receivable. For example, where the contract is a sales contract, this means payment to the seller. However, under paragraph 2, once the debtor receives notification of a security right, it can only be discharged by paying either the secured creditor or another party, as instructed by the secured creditor in the notification or as subsequently instructed by the secured creditor in a written payment instruction received by the debtor. However, the rule in paragraph 2 is subject to a number of qualifications that are set out in paragraphs 3-8.

400. First, under paragraph 3, if the debtor of the receivable receives more than one payment instruction relating to a single security right (and, therefore, from the same secured creditor) in the same receivable created by the same grantor, it is discharged by paying in accordance with the last payment instruction received from

the secured creditor before payment, as the last payment instruction will be the most recent (a payment instruction is conceptually distinct from notification; see para. 386 above).

401. Second, under paragraph 4, if the debtor of the receivable receives notification of more than one security right in the same receivable created by the same grantor, it is discharged by paying in accordance with the first notification received. In this way, the debtor of the receivable, having received one notification of a security right, need not inquire whether the grantor retained any right to create a second security right and, if so, which notification should be complied with. This rule also reflects the fact that it is likely that the security right covered by the first notification will have priority over the subsequent security right under the Model Law's priority rules. As already noted (see para. 381 above), the debtor of the receivable is discharged even if the first notification does not relate to the security right with priority, since the debtor cannot be required to determine which security right has priority. In such a case, the secured creditor with a security right that has priority will have to claim the proceeds of payment from the creditor to whom the debtor made the payment.

402. Third, under paragraph 5, if the debtor of the receivable receives notification of one or more subsequent security rights in the same receivable, it is discharged by paying in accordance with the notification of the last of such subsequent security rights (under art. 2, subpara. (kk), the term "security right" includes outright transfers of receivables). The following example illustrates the operation of paragraph 5. A, to whom a receivable is owed, makes an outright transfer of the receivable to B. B makes an outright transfer of the receivable to C. If the debtor of the receivable receives a notification from each of B and C, it will be discharged by paying C. The reason is that the last transferee in such a series of successive outright transfers is most likely to be the person entitled to payment. One side effect of this rule, along with the rule in paragraph 4, is that the debtor of the receivable needs to be able to distinguish between multiple notifications relating to security rights granted by the same grantor (in which case the debtor of the receivable must pay in accordance with the first notification) and notifications of multiple subsequent security rights (in which case the debtor of the receivable must pay in accordance with the last notification). Paragraphs 8 and 9 provide ways for the debtor of the receivable to ensure that it will not make payment to the wrong person (see paras. 397 and 398 above).

403. Fourth, under paragraph 6, where the debtor of the receivable receives notification of a security right in a part of, or an undivided interest in, one or more receivables, the debtor has a choice. It is discharged by paying either in accordance with the notification or in accordance with paragraph 1 as if the debtor had not received the notification. However, if the debtor chooses the first of these

alternatives, under paragraph 7, it is discharged only to the extent of the part or undivided interest paid.

404. Finally, under paragraph 8, if the debtor of the receivable receives notification from a person claiming to have a security right in the receivable and wants to make sure that that person is a secured creditor to whom payment will discharge the debtor of the receivable, the debtor of the receivable may request that person to provide, within a reasonable time, adequate proof of the creation of the security right. If the asserted security right was created by an initial or subsequent secured creditor, the adequate proof must include proof of the initial and subsequent security rights. If the person claiming to have a security right fails to provide the required proof, the debtor may pay as if it had not received the notification sent by that person. For this purpose, under paragraph 9, adequate proof includes any writing from the grantor that indicates that a security right has been created (e.g. a security agreement).

405. Paragraph 10 is intended to preserve any other ground for discharge based on payment to the person entitled to payment, as well as payment to a competent judicial or other authority, or to a public fund, under other law. For example, under paragraph 10, the debtor of the receivable is discharged if it pays the right person pursuant to a notification conforming with the requirements of the other applicable law but not with the requirements of articles 2 (y), 62 and 63, paragraphs 1-9. Similarly, the debtor of the receivable is discharged by making payment to a competent judicial or other authority, or to a public fund if so provided by the applicable law (e.g. where the debtor of the receivable receives notifications by different secured creditors and is not certain whom to pay in order to be discharged).

Article 64. Defences and rights of set-off of the debtor of the receivable

406. Article 64 is based on recommendation 120 of the Secured Transactions Guide (see chap. VII, para. 21), which in turn is based on article 18 of the Assignment Convention. Paragraph 1 (a) preserves, for the benefit of the debtor of the receivable, all defences and rights of set-off arising from the contract giving rise to the receivable, including any other contract that was part of the same transaction, as if the security right had never been created and the claim were made by the grantor. Paragraph 1 (b) ensures that the debtor of the receivable can assert against the secured creditor any other right of set-off that was available to the debtor at the time it received notification of the security right. This means, however, that the debtor may not assert a right of set-off other than that set out in paragraph 1 (a) that arises subsequent to such notification. Under article 65, however, the debtor may agree not to raise the above-mentioned defences and rights of set-off against the secured creditor.

407. Consistent with article 13, paragraph 2 of article 64 provides that paragraph 1 does not give the debtor of the receivable the right to raise against the secured creditor, as a defence or right of set-off, the breach of an agreement by the grantor that limits the grantor's right to create a security right in the receivable. Otherwise, the validation of a security right created notwithstanding such an agreement, as provided in article 13, would be meaningless.

Article 65. Agreement not to raise defences or rights of set-off

408. Article 65 is based on recommendation 121 of the Secured Transactions Guide (see chap. VII, para. 22), which in turn is based on article 19 of the Assignment Convention. Paragraph 1 provides that the debtor of the receivable may agree, in a signed written agreement with the grantor, not to raise against the secured creditor the defences and rights of set-off that it could otherwise raise against that secured creditor under article 64. The secured creditor is entitled to invoke the benefit of such an agreement even though it is not a party to it.

409. Under paragraph 2, any modification to such an agreement must also be in a written agreement between the grantor and the debtor of the receivable that is signed by the debtor of the receivable. The modification is effective as against the secured creditor only if the secured creditor consents or, in the case of a receivable that has not been earned yet by performance, a reasonable secured creditor would consent (see art. 66, para. 2, and para. 395 above).

410. To avoid abuses, paragraph 3 provides that the debtor may not waive defences based on fraud committed by the secured creditor or on the debtor's incapacity. Paragraph 3, however, does not prevent the debtor of the receivable (e.g. the buyer in a sales agreement) from waiving defences relating to fraud committed by the grantor (e.g. the seller). A waiver of such defences by the debtor of the receivable reduces the need for the secured creditor to conduct an investigation in this regard.

Article 66. Modification of the contract giving rise to a receivable

411. Article 66 is based on recommendation 122 of the Secured Transactions Guide (see chap. VII, paras. 23 and 24), which in turn is based on article 20 of the Assignment Convention. It addresses the impact of an agreement between the grantor of a security right in a receivable and the debtor of the receivable that modifies the terms of the receivable. The result depends on when the agreement

is made. Under paragraph 1, if the agreement is concluded before the debtor receives notification of a security right in the receivable, it is effective against the secured creditor, but the secured creditor also enjoys any benefits derived from the agreement.

412. Under paragraph 2, even if the agreement is concluded after notification, it is also effective, even if it affects the secured creditor's rights provided that: (a) the secured creditor consents to it; or (b) the receivable has not been fully earned by performance and either the modification was provided for in the contract giving rise to the receivable or a reasonable secured creditor would consent to the modification. If none of these conditions is met, an agreement concluded after notification of the security right is not effective against the secured creditor. Paragraph 3 provides that paragraphs 1 and 2 do not affect any right of the grantor or secured creditor for breach of an agreement between them (such as an agreement that the grantor would not agree to any modifications of the terms of the receivable).

Article 67. Recovery of payments

413. Article 67 is based on recommendation 123 of the Secured Transactions Guide (see chap. VII, paras. 25 and 26), which in turn is based on article 21 of the Assignment Convention. It addresses the situation in which the grantor of a security right in a receivable (including the transferor in an outright transfer of the receivable by agreement) fails to perform its obligations under the contract giving rise to the receivable. The article insulates the secured creditor from liability in this situation, by providing that the debtor of the receivable may not look to the secured creditor for recovery of any amount that it has paid to either the grantor or the secured creditor. As a result, the sole recourse of the debtor of the receivable in such a situation is against the grantor and the debtor of the receivable bears the risk of the grantor's insolvency.

B. Negotiable instruments

Article 68. Rights as against the obligor under a negotiable instrument

414. Article 68 is based on recommendation 124 of the Secured Transactions Guide (see chap. VII, paras. 27-31). It is intended to preserve the rights of parties under the law of the enacting State relating to negotiable instruments (to be specified by the enacting State in its enactment of this article). For example, if the enacting State's law is substantively identical to the Bills and Notes Convention: (a) the maker of a note is obliged to pay the secured creditor with a security right

in the note only if the secured creditor is a holder of the note; (b) the maker of a note is obliged to pay the secured creditor only when payment becomes due under the terms of the note; (c) if the secured creditor is a “protected holder” of a note, the defences that the maker of the note may raise against the secured creditor may be significantly limited. It should be noted that the reference in article 68 (as well as arts. 70 and 71) to other law relating to negotiable instruments to be specified by the enacting State will be the law of the enacting State only if that law is the applicable law under the conflict-of-laws rules of chapter VIII.

C. Rights to payment of funds credited to a bank account

Article 69. Rights as against the deposit-taking institution

415. Article 69 is based on recommendations 125 and 126 of the Secured Transactions Guide (see chap. VII, paras. 32-37). It addresses the situation in which a security right is created in a right to payment of funds credited to a bank account.

416. Paragraph 1 (a) provides that the rights and obligations of the deposit-taking institution are unaffected by the security right, unless the institution consents. The rationale for protecting deposit-taking institutions in this manner is that imposing duties on such an institution or changing the rights and duties of the institution without its consent may subject that institution to risks that it is not in a position to manage appropriately unless it knows in advance what those risks might be, and to the risk of having to violate obligations imposed by other law, such as sanctions law (see Secured Transactions Guide, chap. VII, para. 33).

417. To safeguard the confidentiality of the relationship of a deposit-taking institution and its client that is imposed by regulatory or other law, paragraph 1 (b) also provides that the deposit-taking institution has no obligation to respond to requests from third parties for information (e.g. about the balance in the account, whether a control agreement exists or whether the account holder retains the right to dispose of funds credited to its bank account).

418. Paragraph 2 addresses situations in which the deposit-taking institution has a security right in the right to payment of funds credited to a bank account maintained at that institution and also has a right of set-off against that right to payment of funds. The paragraph provides that the deposit-taking institution’s right of set-off is not limited by the security right. Thus, if, under applicable set-off law, the set-off rights are broader than the rights of a secured creditor under the Model Law, the deposit-taking institution may avail itself of those broader rights law (see Secured Transactions, chap. VII, para. 34; for the rights of set-off of the debtor of the receivable, see art. 64, para. 1, and para. 389 above).

D. Negotiable documents and tangible assets covered by negotiable documents

Article 70. Rights as against the issuer of a negotiable document

419. Article 70 is based on recommendation 130 of the Secured Transactions Guide (see chap. VII, paras. 43-45). It provides that, when a secured creditor has a security right in a negotiable document, the rights of the secured creditor as against the issuer of the document or any person obliged on the document are determined by the law relating to negotiable documents of the enacting State (to be specified by the enacting State in its enactment of this article).

E. Non-intermediated securities

Article 71. Rights as against the issuer of a non-intermediated security

420. As already mentioned, the Secured Transactions Guide does not address security rights in any types of securities (see rec. 4 (c)). Thus, article 71 has no antecedent in the Secured Transactions Guide. In line with articles 68-70, it provides that the rights of a secured creditor holding a security right in non-intermediated securities as against the issuer of the securities are determined by other law of the enacting State (to be specified by the enacting State in its enactment of this article).

Chapter VII. Enforcement of a security right

A. General rules

Article 72. Post-default rights

421. Article 72 is based on recommendations 133, 139, 141, 143 and 144 of the Secured Transactions Guide (see chap. VIII, paras. 10-12, 15-17, and 34 and 35). Paragraph 1 provides that, following the grantor's default, the grantor and the secured creditor may exercise any right they have under the provisions of chapter VII, other law or the security agreement, provided that, in the last two cases, that right is not inconsistent with the provisions of the Model Law. In denying effect to any inconsistent terms of the security agreement, this proviso indirectly operates to limit party autonomy in relation to enforcement (for an additional limit to party autonomy, see para. 424 below).

422. For the purposes of the Model Law, "default" is defined to mean the failure of the debtor to pay or otherwise perform the obligation secured by the security right and any other event agreed to by the parties in their security agreement as constituting "default" (see art. 2, subpara. (j), and para. 44 above). It should be noted that the only one of the secured creditor's rights provided in this chapter that may be exercised before default is the right to collect an encumbered receivable (see art. 82, para. 2, and 83).

423. The Model Law adopts the policy that maximizing flexibility in enforcement is likely to increase the efficiency of the enforcement process (see Secured Transactions Guide, rec. 143 and chap. VIII, para. 34). Accordingly, paragraph 2 indicates that the exercise of one post-default right does not prevent the exercise of another post-default right, except if the exercise of one right makes it impossible to exercise of the other right. For example, a secured creditor that obtains possession of an encumbered asset under article 77 with the initial intention of disposing of it under article 78 may thereafter propose to acquire it in satisfaction of the secured obligation under article 80. Indeed, the secured creditor cannot make that proposal if it has already sold or agreed to sell the asset.

424. Paragraph 3 provides that, before default, neither the grantor nor the debtor (defined to include a secondary debtor such as a guarantor of the secured obligation; see art. 2, subpara. (h)) may waive unilaterally or vary by agreement its rights under this chapter. In the absence of this provision, a secured creditor with superior bargaining power could put pressure on them to waive or vary their rights before default in return for concessions in the security agreement (see Secured Transactions Guide, chap. VIII, paras. 16 and 17). After default, this is no longer an issue and thus the grantor or the debtor may then waive or vary its rights under the provisions of this chapter.

425. With the exception of article 83, the provisions of this chapter do not apply to an outright transfer of receivables by agreement (see art. 1, para. 2, and para. 23 above). Consequently, the terms “encumbered asset”, “grantor”, “secured creditor”, “security agreement” and “security right” in articles 72-82 should be read with this exclusion in mind.

Article 73. Methods of exercising post-default rights

426. Article 73 is based on recommendation 142 of the Secured Transactions Guide (see chap. VIII, paras. 18-20 and 29-33). Paragraph 1 provides that the secured creditor has a choice to exercise its post-default rights judicially (i.e. by application to a court or other authority vested with adjudicative power) or extrajudicially (i.e. without an application to a court or other authority). It should be noted that public notaries, bailiffs, sheriffs or other court enforcement officers typically assist in enforcement by a court or other authority but do not have adjudicative powers to resolve disputes and issue decisions binding on all parties.

427. A secured creditor may prefer to exercise its post-default rights by application to a court or other authority for various reasons. For example: (a) judicial or similar proceedings may be efficient; (b) the secured creditor may wish to avoid having its extrajudicial actions subsequently challenged; (c) the secured creditor may anticipate that it will have to apply to a court or other authority anyway to recover an anticipated deficiency; or (d) the secured creditor may fear and wish to avoid a breach of public order (see Secured Transactions Guide, chap. VIII, paras. 32 and 33).

428. A secured creditor may instead elect to exercise its post-default rights extrajudicially because, for example, it fears that judicial proceedings may be too slow and costly, or less likely to produce an appropriate amount upon the disposition of the encumbered assets (see Secured Transactions Guide, chap. VIII, paras. 29 and 31). In the event that a dispute arises in the course of the extra-judicial exercise of the secured creditor’s rights, where other law permits, the parties to the dispute

may agree to resolve it by an alternative dispute resolution mechanism (see art. 3, para. 3, and para. 75 above).

429. Under paragraph 2, the secured creditor's judicial exercise of its post-default rights is subject to the provisions of this chapter and to the provisions that are specified for this purpose by the enacting State. As inefficient enforcement mechanisms are likely to have a negative impact on the availability and the cost of credit (see Secured Transactions Guide, chap. VIII, para. 29), paragraph 2 also refers to expeditious enforcement proceedings. For example, such proceedings may include proceedings involving only affidavit evidence, proceedings in which hearings are held, challenges are disposed of and decisions are rendered in as expeditious a manner as possible, and proceedings in which court decisions are enforced without an official seizure or sale of assets (see Secured Transactions Guide, chap. VIII, para. 33).

430. Under paragraph 3, the extrajudicial exercise by the secured creditor of its post-default rights is governed by the provisions of this chapter. These provisions incorporate advance notice and other procedural protections for the grantor, the debtor and third parties whose rights may be affected. For example, under article 77, paragraph 2, the secured creditor may only exercise its extra-judicial right to possession of the encumbered asset if it has the grantor's advance written consent, notified the grantor and any person in possession of the debtor's default and of its intent to obtain possession, and the person in possession does not object (see further para. 441 below).

431. Moreover, a secured creditor's extrajudicial exercise of its post-default rights is subject to the overarching obligation in article 4 to exercise those rights in good faith and in a commercially reasonable manner. In this respect, it should be noted that the Model Law does not preclude recourse to the assistance of a court or other authority at any time to resolve a dispute arising in relation to the extrajudicial exercise of a post-default right. To the contrary, under article 74, if the secured creditor does not comply with its obligations under this chapter, the persons listed in option A or option B are entitled to apply for expeditious relief from the court or other authority specified by the enacting State.

Article 74. Relief for non-compliance

432. Article 74 is based on recommendation 137 of the Secured Transactions Guide (see chap. VII, para. 31). It addresses the availability of relief from a court or other specified authority in the case of a person's non-compliance with its obligations under the provisions of this chapter. It also requires the enacting State to specify the court or other authority to which the party seeking relief should apply and to provide also for expeditious forms of proceedings (see para. 429 above).

433. Two options are provided for the enacting State to choose between. The first option addresses non-compliance only by the secured creditor, and provides that relief may be sought by: (a) the grantor; (b) any other person with a right in the encumbered asset whose rights are affected by that non-compliance; or (c) the debtor. The second option is broader, addressing non-compliance by any person, and giving any person affected by that non-compliance the right to seek relief. It should be noted that a breach of the secured creditor's obligations under the provisions of this chapter would typically include a breach by persons acting on behalf of the secured creditor (such as representatives, employees or service providers). It should also be noted that the persons that may be affected include: (a) a competing claimant; (b) a guarantor of the secured obligation; or (c) a co-owner of an asset in which another co-owner has created a security right.

Article 75. Right of affected persons to terminate enforcement

434. Article 75 is based on recommendation 140 of the Secured Transactions Guide (see chap. VIII, paras. 22-24). Paragraph 1 entitles the grantor, any other person with a right in the encumbered asset or the debtor to terminate the enforcement process by paying or otherwise performing the secured obligation in full (which in some jurisdictions is known as the right to "redeem" the encumbered asset). In practice, this right is likely to be exercised when the value of the encumbered asset is significantly higher than the amount of the obligation secured by the security right of the enforcing secured creditor. It should be noted that, unlike recommendation 140 of the Secured Transactions Guide, article 75 does not address the extinguishment of a security right, because this matter is addressed in article 12 of the Model Law.

435. Full payment, for the purposes of paragraph 1, includes payment of the reasonable cost of enforcement incurred by the secured creditor whose enforcement is sought to be terminated. If the party exercising the termination right challenges the reasonableness of the enforcing creditor's statement of its enforcement costs and enforcement was initiated by an application to a court or other authority, this dispute would be resolved by the relevant authority. In the case of extrajudicial enforcement, the party exercising the termination right may seek the assistance of a court or other authority specified in article 74 to determine whether the secured creditor's assertion that the cost of enforcement is reasonable.

436. Under paragraph 2, the right to terminate enforcement is extinguished once the relevant enforcement process has been completed or a third party has entered into an agreement to acquire rights in the asset (see para. 438 below). Thus, this right cannot be exercised once the secured creditor has sold or otherwise disposed

of, acquired or collected the encumbered asset, or entered into an agreement for the sale or other disposition of the encumbered asset. Otherwise, the finality of acquired rights would be undermined (see further paras. 460-463 below). Under paragraph 3, the right to terminate enforcement may still be exercised even after the secured creditor has enforced its security right by entering into a lease or licence agreement under article 78. However, the party exercising the termination right must respect the rights of the lessee or licensee under its agreement with the secured creditor whose enforcement has been terminated.

Article 76. Right of a higher-ranking secured creditor to take over enforcement

437. Article 76 is based on recommendation 145 of the Secured Transactions Guide (see chap. VIII, para. 36). Paragraph 1 deals with a situation where a lower-ranking secured creditor or a judgment creditor has commenced enforcement. It entitles a secured creditor, whose security right has priority over that of the enforcing creditor (“higher-ranking secured creditor”) to take over enforcement. The right of the higher-ranking secured creditor to take over enforcement, if it so wishes, is justified because of the potential impact of enforcement on its rights. In particular, if a lower-ranking creditor exercises its right to dispose of the encumbered asset judicially, the security right of the higher-ranking secured creditor will usually be extinguished (see art. 81, para. 1, and para. 460 below) and replaced by a right to priority of payment out of the proceeds realized by the lower-ranking creditor (see art. 79, para. 1 and para. 451 below); it therefore has an interest in controlling the enforcement process. If the lower-ranking creditor instead exercises its disposition right extrajudicially, the security right of the higher-ranking creditor will follow the asset into the hands of the transferee to whom the enforcing creditor disposes of the asset (see art. 81, para. 3, and para. 461 below), thereby potentially forcing the higher-ranking secured creditor to commence enforcement proceedings against that transferee.

438. As in the case of the right of termination in article 75, the right of the higher-ranking secured creditor to take over the enforcement process under this article must be exercised before the asset is sold or otherwise disposed of, acquired, or collected by the lower-ranking creditor or before the conclusion of an agreement by the lower-ranking creditor with a third party to dispose of the encumbered asset. This is because, at this point of time, the enforcement process has advanced so far that it is no longer possible for the higher-ranking secured creditor to take over. However, if the lower-ranking creditor has exercised its enforcement rights extrajudicially, the higher-ranking secured creditor is entitled to enforce its security right in the encumbered asset against the person that acquired the asset from the lower-ranking secured creditor (see paras. 434 above and 460 below).

439. Under paragraph 2, the right of the higher-ranking secured creditor to take over the enforcement process includes the right to enforce by any of the methods provided in this chapter. This means that the higher-ranking secured creditor may elect to pursue a different enforcement right than that contemplated by the original enforcing creditor. It should be noted, however, that the exercise of this right is subject to the standard in article 4. Accordingly, the secured creditor is obliged to act in good faith and in a commercially reasonable manner, so that it should, for example, avoid incurring unreasonable additional enforcement costs.

Article 77. Right of the secured creditor to obtain possession of an encumbered asset

440. Article 77 is based on recommendations 146 and 147 of the Secured Transactions Guide (see chap. VIII, paras. 37-48 and 51-56). It applies only to tangible assets, as only tangible assets may be the subject of possession (for the definitions of the terms “tangible asset” and “possession”, see art. 2, subparas. (ll) and (z), and paras. 69 and 56). Paragraph 1 provides a secured creditor with two options for obtaining possession of a tangible encumbered asset. First, the secured creditor may obtain possession of an encumbered asset by application to a court or other authority. Alternatively, the secured creditor may obtain possession extrajudicially, provided that the conditions set out in paragraphs 2 and 3 are satisfied. Regardless of whether it proceeds judicially or extrajudicially, the secured creditor’s right to possession under paragraph 1 is subordinate to the right of a person that has a superior right to possession (e.g. a lessee or licensee whose rights are not affected by a security right under art. 34, para. 3 or para. 5).

441. Under paragraph 2, the secured creditor’s right to obtain possession extrajudicially is available only if all the conditions set out in that paragraph are met. These conditions are designed to protect the public interest in a peaceful enforcement process and to ensure that the interests of the grantor or other person in possession are not unduly prejudiced. First, the grantor must have consented in writing to the secured creditor obtaining possession without resort to a court or other authority (typically, the secured creditor will obtain the grantor’s consent in the security agreement). Second, the secured creditor must give the grantor, and any person in possession of the encumbered asset, notice of default and of the secured creditor’s intent to obtain possession (the enacting State may wish to specify how much advance notice must be given and select a period that would be in line with the good faith and commercial reasonableness standard in art. 4). Third, and perhaps most important, the person in possession of the encumbered asset at the relevant time must not object to the secured creditor obtaining possession. Thus, the secured creditor must obtain the assistance of a court or other

authority if the person in possession objects, even if that person is the grantor and even if the grantor has previously agreed to allow the secured creditor to obtain possession extrajudicially.

442. It should be noted, however, that a secured creditor is usually entitled to be reimbursed for its reasonable enforcement costs from the proceeds realized from a disposition of the encumbered asset. It follows that, as a practical matter, the person in possession is unlikely to raise unfounded objections since this may expose that person to liability to pay the additional costs incurred by the secured creditor in having to seek judicial assistance.

443. Paragraph 3 recognizes that even a relatively short delay in giving the advance notice required by paragraph 2 can be economically wasteful if the encumbered assets are perishable or otherwise likely to decline speedily in value. Accordingly, paragraph 3 dispenses with the advance notice requirement in those cases.

444. Under paragraph 4, a lower-ranking secured creditor is not entitled to obtain possession of an encumbered asset that is in the possession of a higher-ranking secured creditor, unless otherwise agreed. The purpose of this provision is twofold. First, to ensure that the lower-ranking secured creditor cannot interfere with the exercise of the enforcement rights of the higher-ranking secured creditor who has obtained possession for the purposes of enforcement. Second, to ensure that the security right of a higher-ranking secured creditor that was made effective against third parties by possession does not cease to be effective against third parties or lose its priority status achieved through possession being lost to the lower-ranking secured creditor.

445. It should be noted that the lower-ranking secured creditor may exercise its right to dispose of the encumbered asset under article 78 without obtaining possession, for example, by selling it extrajudicially. The buyer in this situation will acquire its rights subject to the right of the higher-ranking secured creditor, but, as a practical matter, could obtain possession only by paying off the higher-ranking secured creditor (see art. 81, para. 3, and para. 461 below). If the lower-ranking secured creditor instead exercises its disposition right judicially, the security right of the higher-ranking secured creditor will be extinguished (in States that enact art. 81, para. 1 in accordance with para. 460 below), meaning that the buyer will be entitled to obtain possession. However, the higher-ranking secured creditor will be entitled to priority of payment out of the proceeds of the disposition (see art. 79). It follows that the lower-ranking creditor is unlikely to initiate judicial disposition proceedings unless the proceeds to be realised from the disposition of the encumbered asset are likely to be sufficient to satisfy both its claim and the amount owed to the higher-ranking secured creditor.

Article 78. Right of the secured creditor to dispose of an encumbered asset

446. Article 78 is based on recommendations 148-151 of the Secured Transactions Guide (see chap. VIII, paras. 48 and 57-60). Paragraph 1 provides that the secured creditor may sell or otherwise dispose of, lease or license an encumbered asset judicially or extrajudicially. Paragraph 2 provides that, if the secured creditor elects the former option it must act in accordance with the rules specified by the enacting State that determine the method, manner, time, place and other aspects of the sale or other disposition, lease or licence. It should be noted that a secured creditor may exercise this right in relation to a tangible asset without necessarily obtaining possession and that the right could also be exercised when the encumbered asset was an intangible asset (see para. 440 above).

447. Paragraphs 3-8 deal with extrajudicial dispositions by the secured creditor. Under paragraph 3, provided that its actions are in conformity with the overarching obligation to act in good faith and in a commercially reasonable manner (see art. 4), the secured creditor is entitled to determine all aspects of the sale or other disposition, lease or licence, including: (a) the method, manner, time and place; and (b) whether to sell or otherwise dispose of, lease or license the encumbered assets individually, in groups or all together (see Secured Transactions Guide, chap. VIII, paras. 71-73).

448. Under paragraph 4, the secured creditor must give advance written notice of its intention to dispose of the encumbered assets extrajudicially to the grantor, the debtor, any person with a right in the encumbered asset that notifies the secured creditor in writing of those rights, any other secured creditor that registered a notice in the Registry and any other secured creditor in possession (see paras. 4 (a)-(d)). In the case of other persons with rights in the encumbered asset that notified the enforcing secured creditor of their rights or secured creditors that registered a notice in the Registry (see paras. 4 (b) and (c)), the enforcing secured creditor has to give notice of its intention to those persons before the notice is sent to the grantor. The enacting State will need to specify a short period of time which should exist before the notice is sent to the grantor (e.g. one to five days to allow those other secured creditors to exercise their rights, for example, to take over enforcement under article 76).

449. Paragraph 5 sets out the specific information that must be included in the notice. The enacting State will need to specify the period of advance notice (e.g. 10 to 15 days, to give the grantor and other addressees of the notice sufficient time to consider whether to take any action, including whether to exercise their right under art. 75 to terminate the enforcement process). Paragraph 6 requires the notice to be in a language that is reasonably expected to inform the recipient about its content and paragraph 7 provides that the language of the security agreement is sufficient to meet this standard.

450. Under paragraph 8, the notice need not be given if the encumbered asset is perishable, may decline in value speedily, or is of a kind sold on a recognized market. “Recognized market” in this context means an organized market in which large volumes of similar assets are bought and sold between many different sellers and buyers, and accordingly one in which prices are set by the market and not negotiated between individual sellers and buyers. For example, a recognized market would include a commodity exchange through which commodities (e.g. coffee) may be bought and sold at publicly-quoted prices.

Article 79. Distribution of the proceeds of a disposition of an encumbered asset and debtor’s liability for any deficiency

451. Article 79 is based on recommendations 152-155 of the Secured Transactions Guide (see chap. VIII, paras. 60-64). It addresses the distribution of the proceeds of a sale or other disposition, lease or licence under article 78. If the secured creditor initiated the disposition by application to a court or other authority, paragraph 1 provides that distribution of the proceeds is determined by rules that must be specified by the enacting State, but the distribution must be in accordance with the priority provisions of the Model Law. This requirement should be read in light of article 81, paragraphs 1 and 2. Article 79, paragraph 1, requires secured creditors to be paid from the proceeds of a court-supervised disposition in their order of priority. Thus, the enacting State should specify in article 81, paragraphs 1 and 2, that a transferee acquires its rights in the encumbered asset free of, and a lessee or licensee is entitled to the benefit of the lease or licence unaffected by, any security rights in the encumbered asset, including security rights having priority over the security right of the enforcing creditor (see para. 459 below).

452. Paragraph 2 addresses the distribution of the proceeds of an extrajudicial sale or other disposition, lease or licence that is carried out by a secured creditor. Under paragraph 2 (a), the enforcing secured creditor is entitled to apply the proceeds in satisfaction of the obligation secured by its security right after first reimbursing itself for its reasonable costs of enforcement. Under paragraph 2 (b), any surplus must be paid to lower-ranking competing claimants that have notified the enforcing secured creditor of their claims, with any remaining balance then paid to the grantor. This is so because the rights of lower-ranking competing claimants in the encumbered asset are extinguished under article 81, paragraph 3. Alternatively, in order to relieve the enforcing creditor of having to determine the order of priority of competing claimants, paragraph 2 (c) entitles the enforcing secured creditor to pay the surplus to the judicial or other authority or fund specified by the enacting State for distribution in accordance with the provisions of the Model Law on priority. It should be emphasized that paragraph 2 (c) does not entitle higher-ranking creditors to payment from the proceeds. This is because, under article 81, paragraphs 3 and 4, the security right

of a higher-ranking secured creditor is not extinguished by an extrajudicial disposition made by a lower-ranking secured creditor.

453. If the net proceeds of disposition are insufficient to satisfy the obligation secured by the security right of the enforcing secured creditor, paragraph 3 confirms that the debtor remains personally obliged to pay the deficiency. The Model Law does not address the question of whether the debtor's obligation may be reduced or extinguished if the secured creditor failed to comply with the provisions of this chapter governing dispositions or failed to exercise its post-default rights in good faith and in a commercially reasonable manner. Whether the debtor has a claim or counter-claim in these circumstances is a matter left to other law of the enacting State, including in particular its consumer protection law.

454. For the provisions of paragraphs 2 and 3 to operate as intended, the secured creditor will need to provide an account of the disposition, specifying the amount of proceeds realized, how they were distributed and the amount of any surplus or deficiency.

Article 80. Right to propose the acquisition of an encumbered asset by the secured creditor

455. Article 80 is based on recommendations 156-159 of the Secured Transactions Guide (see chap. VIII, paras. 65-70). It applies to the enforcement of a security right in both tangible and intangible assets. Paragraph 1 entitles a secured creditor to make a proposal in writing to acquire one or more of the encumbered assets in total or partial satisfaction of the obligation secured by its security right. Under paragraph 2, the secured creditor must send the proposal to the same categories of persons to whom advance notice of an intended extrajudicial disposition must be sent under article 78, paragraph 4 (see para. 448 above). In the case of other persons with rights in the encumbered asset that notified the enforcing secured creditor of their rights or secured creditors that registered a notice in the Registry (see paras. 2 (b) and (c)), the enforcing secured creditor has to give notice to those other secured creditors at least a short period of time specified by the enacting State (e.g. one to five days to allow those persons to exercise their rights before the proposal is sent) before the proposal is sent to the grantor.

456. Paragraph 3 sets out the required content of the proposal. Whether a proposal that contains erroneous information or omits required information would result in the secured creditor failing to acquire the encumbered asset would depend (by analogy to article 81, paragraph 5) on whether the error or omission materially prejudiced the rights of the persons entitled to receive the proposal (e.g. a substantial misstatement of the amount of the secured obligation would typically be viewed as resulting in material prejudice).

457. In the case of a proposal for the acquisition of an encumbered asset in full satisfaction of the secured obligation, paragraph 4 provides that the secured creditor acquires the encumbered asset so long as none of the persons to whom the proposal must be sent under paragraph 2 objects before the expiry of the period specified by the enacting State after they receive the proposal (e.g. 10 to 15 days to allow these persons sufficient time to consider whether they should object). If a timely objection is made, the secured creditor may not proceed further and may only enforce its security right by disposition under article 78 (or collection under art. 82 where the encumbered asset is a right to payment).

458. In the case of a proposal for the acquisition of an encumbered asset in partial satisfaction of the secured obligation, paragraph 5 provides that the secured creditor acquires the encumbered asset only if all of the persons to whom the proposal must be sent under paragraph 2 positively consent before the expiry of the period specified by the enacting State after they receive the proposal (e.g. 45 days to allow these persons sufficient time to consider whether they should accept). The requirement of positive consent in this paragraph is intended to protect the debtor, since, as the secured obligation is only partially satisfied, it would remain liable for the balance of the obligation. It is also to protect any lower-ranking claimant whose rights would be extinguished under article 81 paragraph 3 (see para. 461 below). As in the case of an unsuccessful proposal under paragraph 3, if the secured creditor does not obtain positive consent, it may only enforce its security right by disposition under article 78 (or collection if the encumbered asset is one of the rights to payment set out in art. 82).

459. Paragraph 6 entitles the grantor to request the secured creditor to make a proposal under paragraph 1. If the secured creditor agrees, paragraphs 1-5 apply in the same manner as if the secured creditor had been the one to initiate the proposal process. In other words, this provision is merely facilitative in nature since the formal proposal process remains the same even where it is initially triggered by a request from the grantor to the secured creditor.

Article 81. Rights acquired in an encumbered asset

460. Article 81 is based on recommendations 160-163 of the Secured Transactions Guide (see chap. VIII, paras. 74-81). It addresses the rights acquired by a buyer or other transferee, or a lessee or licensee, pursuant to a disposition under article 78. Paragraphs 1 and 2 address judicially-supervised dispositions and require the enacting State to specify: (a) in the case of a sale or other transfer, whether or not the transferee acquires the encumbered asset free of any rights; and (b) in the case of a lease or licence, whether or not the lessee or licensee remains entitled to use the encumbered asset during the term of the lease or licence. As already noted (see para. 451 above), article 79, paragraph 1, requires the distribution of the

proceeds of a judicial sale or other disposition, lease or licence to be made in accordance with the priority rules of the Model Law. This requirement means that all secured creditors are entitled to share in the proceeds in order of priority. It follows that the enacting State should specify in paragraphs 1 and 2 that a buyer or other transferee acquires the encumbered asset free of, and a lessee or licensee is entitled to the benefit of the lease or licence unaffected by, any security rights (including security rights ranking higher in priority to that of the enforcing secured creditor).

461. Paragraphs 3 and 4 take a different approach in the case of an extrajudicial sale or other disposition, lease or licence of an encumbered asset. Under paragraph 3, a buyer or other transferee acquires the grantor's right in the encumbered asset free of the security right of the enforcing creditor and the rights of any subordinate competing claimants, but subject to the rights of secured creditors that have priority over the rights of the enforcing secured creditor. The enacting State may wish to consider providing that the rule in article 81, paragraph 3, applies also in the case of the acquisition of an encumbered asset by the secured creditor (see Secured Transactions Guide, rec. 161, second sentence).

462. Paragraph 4 similarly provides that a lessee or licensee under a lease or licence granted by the enforcing creditor is entitled to the benefit of the lease or licence during its term except as against creditors that have priority over the rights of the enforcing creditor. The reason for the difference in approach is that higher-ranking secured creditors are not entitled to share in the proceeds of an extrajudicial enforcement initiated by a lower-ranking creditor (see art. 79, para. 2, and para. 452 above). It follows that a buyer or other transferee will discount the price it is willing to pay for the encumbered asset by the value of any prior-ranking security rights and a lessee or licensee will discount the amount of the rental payments it is willing to pay to address the risk that its right of use may be disrupted if the higher-ranking secured creditor elects to enforce its security right.

463. Paragraph 5 provides that the rights acquired by a buyer or other transferee, or a lessee or licensee under paragraphs 3 and 4 of this article are affected by the enforcing creditor's failure to comply with the requirements of this chapter only if two conditions are satisfied. First, they must have had knowledge of the violation, and second, the breach must have materially prejudiced their rights.

B. Asset-specific rules

Article 82. Collection of payment

464. Article 82 is based on recommendations 169-171, 173 and 175 of the Secured Transactions Guide (see chap. VIII, paras. 93-98, 102-108, 111 and 112).

It provides secured creditors with an additional enforcement right where the encumbered asset is a receivable, negotiable instrument, right to payment of funds credited to a bank account or non-intermediated security. Paragraph 1 entitles the secured creditor to collect payment directly from the relevant obligor after default, as an alternative to selling or otherwise disposing of the encumbered asset under article 78. Under paragraph 2, with the agreement of the grantor, the secured creditor may exercise its right to collect even before default. Under paragraph 3, a secured creditor that collects under paragraph 1 or 2 has the benefit of any personal or property right that secures or supports payment of the encumbered asset (such as a guarantee or a stand-by letter of credit; see art. 14).

465. Paragraph 4 limits the secured creditor's right of collection if the encumbered asset is a right to payment of funds credited to a bank account and the security right was made effective against third parties solely by registration. In this situation, the secured creditor is entitled to collect (or otherwise enforce, for example, through a sale under art. 78 or through a proposal under art. 80) only if it obtains a court order or the deposit-taking institution consents. Paragraph 4 does not limit a secured creditor's right of collection where its security right was made effective against third parties by a method other than registration; that is: (a) automatically by the security right being created in favour of the deposit-taking institution itself; (b) by the conclusion of a control agreement between the deposit-taking institution, the grantor (account holder) and the secured creditor; or (c) by the secured creditor becoming the account holder, a method that requires the consent of the institution (see art. 25). The objective of this approach is to exempt deposit-taking institutions from having to respond to a request for payment sent by a person that asserts to have a security right in a right to payment of funds credited to the grantor's account unless the institution has actively consented to the creation of that security right (see Secured Transactions Guide, chap. VIII, para. 107).

Article 83. Collection of payment by an outright transferee of a receivable

466. Article 83 is based on recommendations 167-168 of the Secured Transactions Guide (see chap. VIII, paras. 99-101). It provides that, in the case of an outright transfer of a receivable, the transferee is entitled to collect the receivable at any time provided that payment has become due. It should be noted that the overarching obligation of good faith and commercial reasonableness in article 4 also extends to the collection of receivables by an outright transferee. As a practical matter, where the receivable is transferred outright without recourse, the transferor cannot by definition be prejudiced by the failure of the transferee to act in good faith and in a commercially reasonable manner in exercising its collection right. However, the standard in article 4 is a general one and would still apply to protect

the obligor on the receivable as well as a prior-ranking creditor even in the case of an outright transfer without recourse.

Chapter VIII. Conflict of laws

Introduction

467. Chapter VIII of the Model Law states the rules for determining the State whose substantive law is applicable to the issues dealt with in the other chapters. These rules are generally referred to as the conflict-of-laws rules. In a State that has enacted the Model Law, a court or other authority will use the conflict-of-laws rules of chapter VIII to determine which State's substantive law will govern issues such as the creation, effectiveness against third parties, priority and enforcement of a security right, as well as the mutual rights and obligations of the grantor and the secured creditor and the rights and obligations between third-party obligors and secured creditors. The substantive law indicated by the conflict-of-laws rules may be that of the enacting State or the law of another State.

468. It should be noted that, in the event of judicial proceedings in a State, a court or other authority in that State will typically apply: (a) the substantive law of its own legal system to characterize a transaction (e.g. whether it is a secured transaction in a strict sense or a different kind of transaction such as a retention-of-title sale) or a related issue (e.g. whether it is a priority or enforcement issue) for the purpose of selecting the appropriate conflict-of-laws rule; (b) the conflict-of-laws rules of its own legal system to determine which State's law is applicable to the substance of the dispute; and (c) the substantive law of the State whose law is applicable according to the conflict-of-laws rules of the forum State (for a more elaborate discussion of the role of conflict-of-laws rules, see Secured Transactions Guide, chap. X, paras. 1-13). For example, if a State enacts the Model Law and a court in that State characterizes a transaction as a secured transaction in accordance with the Model Law, it would use the rules in chapter VIII to determine which State's substantive law rules should apply, and then apply those rules.

469. The application of the conflict-of-laws rules in chapter VIII are not conditional on a prior determination that a particular case presents an international element. Thus, whenever a conflict-of-laws rule in this chapter refers to the law of a State, that reference should not be refused on the ground of the absence of true "internationality". Otherwise, courts might disregard a conflict-of-laws rule in this chapter by deciding that the case is not sufficiently international on the basis of discretionary criteria that are not part of the conflict-of-laws rules.

470. The conflict-of-laws rules relating to the determination of the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right, as well as to the effect of a security right on a third-party obligor are mandatory (see art. 3, para. 1, and para. 73 above). Therefore, with respect to those matters, the parties cannot be permitted by a choice-of-law clause to avoid the application of the substantive law of the State to which a conflict-of-laws rule refers. This is because security rights are property (*in rem*) rights and thus affect third parties (see art. 3, para. 2, and para. 74 above). Allowing the parties to a security agreement to select the applicable conflict-of-laws rule where the selection has third-party effects would also defeat one of the main purposes of the conflict-of-laws rules, which is to identify the State whose substantive law is to apply in the event of a priority dispute among competing claimants. For example, if there is a priority dispute between secured creditor X and secured creditor Y, it would be impossible for third parties to ascertain the law applicable to the resolution of the dispute if each of X and Y were permitted to choose in their security agreement a different governing law for the ranking of their respective security rights. By contrast, article 84 expressly provides for the possibility of the choice of the applicable law by the parties with respect to their mutual rights and obligations arising from their security agreement. This is because their choice of law has no effect on the rights of third parties.

A. General rules

Article 84. Mutual rights and obligations of the grantor and the secured creditor

471. Article 84 is based on recommendation 216 of the Secured Transactions Guide (see chap. X, para. 61). Following the approach of international texts such as the Hague Principles on Choice of Law in International Commercial Contracts (the “Hague Principles”), article 84 states that the law chosen by the parties to a security agreement is the law applicable to their mutual rights and obligations arising from their agreement (subject only to the limitations set out in article 93). As already mentioned (see para. 470 above), matters relating to the property aspects of secured transactions are outside the scope of article 84. The parties cannot select the law that is to govern these matters. Other matters, such as the ability of the parties to choose different laws for different aspects of their contractual relationship or to modify their choice of law, are left to other conflict-of-laws rules of the enacting State (see, for example, art. 2 (2) and (3) of the Hague Principles).

472. In the absence of a choice of law by the parties, article 84 refers to the law governing the security agreement as determined by the conflict-of-laws rules generally applicable to contractual obligations. For example, this law may be the law of

the State: (a) which is most closely connected to the security agreement (e.g. the State in which a security agreement is entered into and performed, and in which both parties are located); (b) in which the characteristic performance of the agreement is to be made (e.g. the delivery of the goods in a sales agreement or the extension of credit in a credit agreement); or (c) in which the security agreement is entered into.

Article 85. Security rights in tangible assets

473. Article 85 is based on recommendations 203-207 of the Secured Transactions Guide (see chap. X, paras. 28-38). It deals with the law applicable to the creation, effectiveness against third parties and priority of a security right in a tangible asset (for the law applicable to the enforcement of such a security right, see art. 88, subpara. (a), and para. 483 below). The term “tangible asset” is defined to refer generally to all types of tangible movable asset and to include money, negotiable instruments, negotiable documents and certificated non-intermediated securities (see art. 2, subpara. (II); see also Secured Transactions Guide, chap. X, para. 26).

474. Paragraph 1 states the general rule that the law applicable to these issues is the law of the State in which the encumbered asset is located (the “*lex situs*” or the “*lex rei sitae*”; for the meaning of the term “location”, see art. 90, and paras. 488 and 489 below; for the relevant time for determining location, see art. 91). The *lex situs* rule for tangible assets is subject to five exceptions that are set out in articles 85, paragraphs 2 to 4, 98 and 100.

475. The first exception provides that, if a tangible asset located in a State is covered by a negotiable document in the possession of a secured creditor in another State, the priority of the security right over the asset covered by that document as against the rights of competing claimants will be determined by the law of the State in which the document is located, and not by the law of the State in which the asset covered by that document is located (see art. 85, para. 2). Unlike recommendation 206, on which paragraph 2 is based, which referred to priority as against “a competing security right”, to cover all priority conflicts (e.g. as against a judgment creditor), paragraph 2 refers to priority “as against the right of a competing claimant”.

476. The second exception points to the law of the State in which the grantor is located for an asset of a type that is ordinarily used in more than one State, that is, a “mobile asset” (see art. 85, para. 3). This exception refers to the ordinary use of assets of this type and not to the actual use of any individual encumbered asset. For example, as motor vehicles may cross national borders, the rule will apply to a particular motor vehicle even if it is actually used only in one single State.

477. The third exception deals with a tangible asset (other than a mobile asset) in transit or to be exported (see art. 85, para. 4). A security right in a tangible asset which is in transit or destined to be moved to another State may be created and made effective against third parties under the law of the State of its ultimate destination, if the asset reaches that destination within the period of time to be specified by the enacting State (e.g. within 45-60 days after the putative creation of the security right to allow sufficient time for the asset to reach its destination). It should be noted that: (a) if the asset does not reach the intended destination within the period specified, the rule in paragraph 4 will not apply; and (b) under the rule in paragraph 1, a secured creditor may also take the necessary steps to create and make the security right effective against third parties under the law of the State in which the asset is actually located at the time such steps are taken. It should also be noted that paragraph 4 is a conflict-of-laws rule of the enacting State only and whether the security right will be treated as validly created and made effective against third parties in the State of the ultimate destination of the asset depends on the law applicable under the conflict-of-laws rules of that State.

478. The fourth exception is contained in article 98 and is only a partial exception. It applies only to the third-party effectiveness of a security right by registration in certain types of tangible and intangible asset (see paras. 510 and 511 below). However, it does not alter the law applicable to other matters under the primary rule in article 85; questions of priority as against competing claimants, for example, will continue to be determined by the law of the State in which the asset is located.

479. The fifth exception is contained in article 100. It refers matters relating to a security right in certificated securities to laws other than the law of the State in which the certificate is located (see paras. 515-524 below).

Article 86. Security rights in intangible assets

480. Article 86 is based on recommendation 208 of the Secured Transactions Guide (see chap. X, paras. 39-47). It states the general conflict-of-laws rule for the creation, effectiveness against third parties and priority of a security right in an intangible asset. The applicable law is that of the State in which the grantor is located (for the meaning of “location”, see art. 90, and paras. 488 and 489 below; for the relevant time for determining location, see art. 91, and paras. 490-493 below). This rule is subject to several exceptions.

481. The first exception relates to the priority of a security right in a receivable arising from a sale or lease of, or secured by, immovable property (see art. 87, and para. 482 below). The other exceptions relate to a security right in rights to payment of funds credited to a bank account (see art. 97, and paras. 506-509 below), intellectual property (see art. 99, and paras. 512-514 below) and uncertificated

non-intermediated securities (see art. 100, and paras. 515-524 below), as well as to the third-party effectiveness of a security right in certain types of asset by registration (art. 98, and paras. 510 and 511 below).

Article 87. Security rights in receivables relating to immovable property

482. Article 87 is based on recommendation 209 of the Secured Transactions Guide (see chap. X, para. 54). It deals with the priority of a security right in a receivable arising from a sale or lease of immovable property or secured by immovable property as against the rights of competing claimants. Article 87 is an exception to the general rule of article 86 and refers that matter to the law of the State under whose authority the immovable property registry is maintained. However, article 87 applies only if the right of a competing claimant is registrable (but not necessarily registered) in the relevant immovable property registry. This means that, for a person to be certain which State's law is applicable to the priority of a security right in a receivable, that person needs to determine whether the receivable arose from a sale or lease of, or is secured by, immovable property. If that person does not find that out that the receivable arose in the circumstances described in this article, the person may make an inaccurate determination of which law governs.

Article 88. Enforcement of security rights

483. Article 88 is based on recommendation 218 of the Secured Transactions Guide (see chap. X, paras. 64-72). Subparagraph (a) deals with the law applicable to the enforcement of a security right in a tangible asset, as defined in article 2, subparagraph (II). It refers to the law of the State in which the asset is located at the time of commencement of enforcement. The rule in subparagraph (a) is subject to one exception. The enforcement of a security right in certificated non-intermediated securities is referred to the law indicated in article 100 (which applies to both certificated and uncertificated securities).

484. It should be noted that enforcement may involve several distinct actions (e.g. notice of the secured creditor's intent to obtain possession of an encumbered asset without applying to a court or other authority, disposition of an encumbered asset, and distribution of the proceeds of disposition) and these actions may take place in different States. For example, a secured creditor may take possession of the encumbered assets in one State, dispose of them in a second State, and distribute the proceeds of disposition in a third State. A similar issue arises in the less frequent case where enforcement takes place in different States because the asset

has been moved to another State after commencement of enforcement. In each case, the applicable law will be the law of the State of the location of the relevant asset at the time the first enforcement action is taken.

485. Under subparagraph (b), the law applicable to the enforcement of a security right in an intangible asset (with the exception of a right to payment of funds credited to a bank account, intellectual property and uncertificated non-intermediated securities; see arts. 97, 99 and 100, and paras. 506-509 and 512-524 below) is the law of the State whose law governs priority of the security right (see art. 86, and paras. 480 and 481 above). The main advantage of this approach is that the creation, third-party effectiveness, priority and enforcement of a security right in an intangible asset are referred to one and the same law (see Secured Transactions Guide, chap. X, para. 69).

Article 89. Security rights in proceeds

486. Article 89 is based on recommendation 215 of the Secured Transactions Guide (see chap. X, paras. 55-60). It refers the creation of a security right in proceeds to the law of the State whose law governs the creation of the security right in the original encumbered assets, and the third-party effectiveness and priority of a security right in proceeds to the law of the State whose law governs those matters in the case of a security right in original encumbered assets of the same kind as the proceeds. The following example illustrates how article 89 operates. The original encumbered asset is inventory located in State A. The inventory is subsequently sold, and the purchase price is paid by a funds transfer to a bank account held with a deposit-taking institution in State B. Under paragraph 1, the law applicable to the question of whether the secured creditor automatically acquires a security right in the right to payment of the funds credited to the bank account as proceeds of the original encumbered inventory will be the law of the location of the inventory at the time of the creation of the security right in the inventory (see art. 91, para. 1 (a), and para. 491 below). Under paragraph 2, the law applicable to the third-party effectiveness and priority of the security right in the right to payment of the funds credited to the bank account as proceeds will be the law that would be applicable to a security right in the right to payment of the funds credited to the bank account as an original encumbered asset (see art. 97, and paras. 506-509 below).

487. It should be noted that this type of bifurcated rule might lead to difficulties in cases where the law governing creation recognizes a broad-based right in proceeds (including, for example, civil and natural fruits; see art. 2, subpara. (bb), and para. 59 above) whereas the law governing third-party effectiveness and priority recognizes a narrower right in proceeds. It should also be noted that article 89 is dealing only with the law applicable to proceeds derived from the original encumbered assets as a result of a disposition by the grantor or other event prior to

enforcement. Article 88 deals with the law applicable to the distribution of proceeds derived from a disposition of the encumbered assets pursuant to post-default enforcement proceedings.

Article 90. Meaning of “location” of the grantor

488. Article 90 is based on recommendation 219 of the Secured Transactions Guide (see chap. X, paras. 73 and 74). It provides that: (a) if a grantor has a place of business, it is located in that State; (b) if a grantor has a place of business in more than one State, it is located in the State in which the grantor’s central administration is exercised; and (c) if a grantor does not have a place of business, the grantor is located in the State in which the grantor has his or her habitual residence. The term “place of business” is understood in a broad sense and refers to the place in which the grantor exercises its activities (not necessarily commercial activities). Thus, a legal person without any commercial activities (e.g. a foundation) is located in the State in which it is exercising its activities. It should be noted that, if an individual has a habitual residence in one State and a place of business in another State, that individual is located in the latter State even if the transaction pursuant to which the security right is created is for personal, family, or household purposes unrelated to the individual’s commercial activities.

489. It should also be noted that the State in which a grantor that is a legal person has its central administration is not necessarily the State in which that legal person has its statutory seat (or registered office). Thus, if the grantor is a legal person formed under the law of State A with its statutory seat in that State but has in State B a place of business where its senior management is based, then the grantor is located in State B. As a result of article 90, for example, the creation, third-party effectiveness, priority and enforcement of a security right in a receivable is referred to one single law that, as a matter of fact, is relatively easy to determine and is most likely to be the law of the State in which the main insolvency proceeding with respect to the grantor would take place (as insolvency proceedings are typically referred to the law of the State in which the insolvent person has the centre of its main interests and that State is generally interpreted to be the State in which that person has its central administration). This approach minimizes the risks of inconsistencies between the law governing the insolvency proceeding (*lex fori concursus*) and the substantive law applicable to a security right, as the two laws will be the law of one and the same State.

Article 91. Relevant time for determining location

490. Article 91 is based on recommendation 220 of the Secured Transactions Guide (see chap. X, paras. 75-78). It deals with the situation where the applicable

law is determined by reference to the location of the asset or the grantor, and that location changes from one State (State A) to another (State B). In such a situation, the applicable law may change. It should be noted that, if the applicable law changes under article 91 to that of the enacting State, article 23 enables the secured creditor to preserve the third-party effectiveness of its security right (see paras. 132 and 133 above).

491. Paragraph 1 (*a*) establishes that the creation of a security right remains governed by the law of the location of the asset or of the grantor at the time of the creation of the security right even if there is subsequently a change of location. This means that, if the security right was validly created under the law of State A when the asset or the grantor was located there, the law of State A will continue to apply and, as a result, the security right will continue to be held to have been effectively created even after the move of the asset or the grantor to State B whether or not the creation requirements of the law of State B have been satisfied. However, for third-party effectiveness and priority issues, paragraph 1 (*b*) provides that the applicable law will be that of the location of the asset or the grantor “at the time when the issue arises”. This is the time of the occurrence of the event that creates the need to determine the law that would be applicable to third-party effectiveness or priority.

492. For example, if an insolvency proceeding commences in State B in respect of the grantor that is located in State A at the time of the creation of a security right in a receivable, the law applicable to the effectiveness of the security right will be the law of State B if at the time of commencement of the insolvency proceeding the grantor is located in State B (see art. 86, and paras. 480 and 481 above). As a result, for the security right to be effective against the insolvency representative (who is a “competing claimant” under art. 2, subpara. (*e*)) either in State A or in State B, the third-party effectiveness requirements of the law of State B must have been fulfilled prior to the commencement of the insolvency proceeding. Another example is where a tangible asset is seized by a judgment creditor. The question of the respective priority of the secured creditor and the judgment creditor arises at the time of the seizure (which will be “the time when the issue arises”). This is so in each example even if the security right had been made effective against third parties under the law of State A at the time the asset or the grantor was located in State A.

493. Paragraph 2 constitutes an exception to the general rules of paragraph 1. If the rights of all competing claimants have been created and made effective against third parties under the law of the State of the initial location, the priority dispute will be resolved under the law of that State (State A in the example).

Article 92. Exclusion of *renvoi*

494. Article 92 is based on recommendation 221 of the Secured Transactions Guide (see chap. X, para. 14). Its purpose is to exclude the doctrine of *renvoi* and provide greater certainty with respect to the determination of the applicable law by avoiding the complications arising from this doctrine. Under the doctrine of *renvoi*, when the conflict-of-laws rules of a State (State A) refer an issue to the law of another State (State B), that reference includes the private international law rules of State B. If, however, the conflict-of-laws rules of State B refer that issue to the law of another State (State C), under that doctrine, a court in State A would resolve the priority dispute by applying the law of State C (and not the law of State B). This could result in circularity, create uncertainty as to the applicable law and be contrary to the expectations of the parties. For those reasons, article 92 excludes *renvoi* (for an exception, see art. 95, and paras. 501-504 below).

Article 93. Overriding mandatory rules and public policy (ordre public)

495. Article 93, which is based on recommendation 222 of the Secured Transactions Guide (see chap. X, para. 79) and article 11 of the Hague Principles, states generally recognized principles of private international law. Under paragraphs 1 and 3, the forum court is not prevented from applying the overriding mandatory law provisions of the law of the forum State and may exclude the application of a provision of the law applicable under the provisions of this chapter if it is manifestly incompatible with fundamental notions of public policy of the forum State.

496. To illustrate how the rules in paragraphs 1 and 3 will operate, assume that the law of the forum (State A) prohibits dealings in certain types of asset (such as an asset which is the proceeds of criminal activities or is the subject of international sanctions) and that the law of the State whose law is applicable under the provisions of this chapter (State B) does not contain such a mandatory law prohibition. In such a case, a court in State A may refuse to recognize a security right created in such an asset under the law of State B even though the law of State B does not contain the same prohibition. Similarly, even if there is no statutory prohibition in State B on the creation of a security right in a “cultural object”, the forum court (State A) may set aside a provision of the law of State B that allows the creation of a security right in cultural objects as being manifestly incompatible with the public policy of State A.

497. Under paragraphs 2 and 4, if it is allowed to do so under its law, the forum court may refuse to recognize and enforce a security right that has been effectively created and made effective against third parties under the applicable law (even if

the applicable law is the law of the forum itself). The forum court may do so, if the creation of the security right would be manifestly incompatible with the public policy of another State (e.g. a State that has a close connection with the situation). For example, a law firm located in the forum State (State A) may wish to assign receivables arising from its legal services and the law of State A allows this assignment. However, the client is located in another State (State B) and, for reasons of public policy (confidentiality of lawyer-client relationship), the law of State B prohibits the transfers by a law firm of its receivables arising from legal services. In this case, the law of State A may allow a court in State A to take the public policy of State B into account in determining whether the assignment is valid.

498. Paragraph 5 is intended to make clear that the rules in paragraphs 1-4 may also be relied upon by an arbitral tribunal, although, unlike a court, it does not operate as part of the judicial infrastructure of a specific legal system. Under paragraph 5, an arbitral tribunal may be required to take into account the public policy and the overriding mandatory provisions of a State other than the State whose law is applicable (e.g. the State in which the arbitration takes place or the State in which enforcement of any award is likely to take place). Paragraph 5 also requires an arbitral tribunal to determine whether it is required or entitled to take into account the public policy or the overriding mandatory provisions of another law, having regard (in particular) to the agreement of the parties, the designated or deemed seat of the arbitration, any institutional rules applicable to the arbitration, and the potentially controlling influence of State courts applying local arbitration legislation (see commentary to art. 11 (5) of the Hague Principles).

499. Under paragraph 6, the forum State may not displace the provisions of the law applicable to third-party effectiveness and priority of a security right and apply its own third-party effectiveness and priority provisions or those provisions of another State. This approach is justified by the need to achieve certainty with respect to the law applicable to third-party effectiveness and priority. The same approach is followed in article 23, paragraph 2, article 30, paragraph 2, and article 31 of the Assignment Convention, as well as in article 11, paragraph 3, of the Hague Securities Convention.

Article 94. Impact of commencement of insolvency proceedings on the law applicable to a security right

500. Article 94 is based on recommendation 223 of the Secured Transactions Guide (see chap. X, paras. 80-82). It provides that an insolvency court in the enacting State must in principle respect the law applicable to security rights under its conflict-of-laws rules. However, nothing in article 94 restricts the application of the law of the State in which insolvency proceedings are commenced (*lex fori*

concurus) to matters such as the avoidance of fraudulent or preferential transactions, the treatment of secured creditors, the ranking of claims and the distribution of proceeds (see rec. 31 of the Insolvency Guide).

Article 95. Multi-unit States

501. Article 95 is based on recommendations 224-227 of the Secured Transactions Guide (see chap. X, paras. 83-87) and partly on article 37, first sentence, of the Assignment Convention. Its purpose is to deal with the law applicable where the State whose law is applicable to an issue under the provisions of this chapter has two or more territorial units, each of which has its own substantive law, and possibly its own conflict-of-laws rules. In such a case, subparagraph (a) provides that a reference to the law of a multi-unit State is in principle a reference to the law applicable in the relevant unit (as determined under the other provisions of this chapter). For example, in the case of a security right in a receivable created by a grantor located (in the sense of having its central administration) in territorial unit A, the law applicable to that security right is in principle the law of territorial unit A (see arts. 86 and 90, and paras. 480, 481, 488 and 489 above).

502. However, under subparagraph (b), if the internal conflict-of-laws rules of the multi-unit State or, in the absence of such rules, of the territorial unit to which subparagraph (a) points, refer security rights to the law in force in another territorial unit of that State, the substantive law of that other unit will apply. In the above mentioned example, if territorial unit A has a conflict-of-laws rule under which the law applicable is the law of the grantor's location defined as the place of the grantor's statutory seat and that place is in territorial unit B, the substantive law of territorial unit B will apply. It should be noted that subparagraphs (a) and (b) also apply where the forum State is the State whose law is applicable under the provisions of this chapter.

503. Thus, subparagraph (b) is a deviation from the general rule on the exclusion of *renvoi* (see art. 92, and para. 494 above). The purpose of the deviation is to ensure that, where the applicable law is that of a unit of a multi-unit State, a forum court outside that multi-unit State will apply the substantive law of the same unit as a forum court in that multi-unit State would do under its internal conflict-of-laws rules. This deviation from the rule excluding *renvoi* is limited to internal *renvoi* and will not undermine the purposes of the general exclusion of *renvoi* in article 92 (see Secured Transactions Guide, chap. X, para. 85).

504. As a result, for example, where the conflict-of-laws rules of this chapter refer to the law of the location of the asset or the grantor, the forum court is required under the provisions of this chapter to examine the internal conflict-of-laws rules

in effect in the territorial unit of the location of the grantor or the encumbered asset. It should be noted in this regard that, the Assignment Convention allows a declaration by States as to the internal conflict-of-laws rule to be used in determining the applicable priority rule as between various territorial units (see art. 37 of the Assignment Convention). However, article 95 does not provide for a similar option. Accordingly, a forum court will have to ascertain the conflict-of-laws rules in effect in the multi-unit State or, in the absence of such rules, in the territorial unit in order to determine the applicable law.

B. Asset-specific rules

Article 96. Rights and obligations between third-party obligors and secured creditors

505. Article 96 is based on recommendation 217 of the Secured Transactions Guide (see chap. X, paras. 62 and 63) and article 29 of the Assignment Convention. Its purpose is twofold. First, the conflict-of-laws rules dealing with the law applicable to the third-party effectiveness or enforcement of a security right do not apply to the effectiveness or enforcement of a security right against a debtor of a receivable, an obligor under a negotiable instrument or an issuer of a negotiable document; they are not considered “third parties” for the purposes of the rules on third-party effectiveness and priority of a security right, as they are not competing claimants. Second, the law applicable to these issues is the law governing the legal relationship between the grantor and the relevant debtor of the receivable, or the relevant obligor under the instrument or the issuer of the document; the same law also applies to the question of whether any of the latter may assert that their agreement with the grantor prohibits or limits the grantor’s right to create a security right in the relevant receivable, instrument or document. For example, in the case of a receivable arising from a sales contract, the law chosen by the seller/grantor and the buyer/debtor of the receivable to govern the sales contract will apply to the matters covered by article 96.

Article 97. Security rights in rights to payment of funds credited to a bank account

506. Article 97 is based on recommendation 210 of the Secured Transactions Guide (see chap. X, paras. 49-51). While a right to payment of funds credited to a bank account is in the generic sense a receivable of the customer against the deposit-taking institution, article 97 departs from the general conflict-of-laws rule on the law applicable to intangible assets (see art. 86). Two options are offered to the enacting State for the law applicable to the creation, third-party effectiveness,

priority and enforcement of a security right in a right to payment of funds credited to a bank account, as well as to the rights and obligations between the deposit-taking institution and the secured creditor.

507. Under option A, the applicable law is that of the State of the location of the branch (or office) of the deposit-taking institution with which the account is maintained. A branch (or office) of a deposit-taking institution may be considered as being located in a particular jurisdiction irrespective of whether the institution offers its services through physical offices or only through an online connection accessible electronically by customers. In this regard, it should be noted that a deposit-taking institution must generally have a physical presence or legal address in a jurisdiction in order to be allowed by the relevant regulatory authorities to maintain bank accounts in that jurisdiction. Under this approach, certainty and transparency with regard to the applicable law would be enhanced, as the location of the relevant branch could generally be determined easily in the context of a bilateral relationship between a deposit-taking institution and its client. In addition, a State that selects option A is likely to do so because it considers that this option reflects the expectations of the parties to account agreements that the law of the State of the location of the relevant branch will apply. Moreover, this approach would result in the law governing a security right in a right to payment of funds credited to a bank account being the same as that applicable to regulatory matters (see Secured Transactions Guide, chap. X, para. 49).

508. Under option B, the applicable law is the law designated in the account agreement as governing the issues that are the subject of article 97 or, in the absence of a designation of a law for these issues, the law designated by the parties to the account agreement as the law governing that agreement. A State that selects option B is likely to do so because it considers that this option reflects the expectations of the parties that the law of the State that they chose in their account agreement will apply. A potential lender would be able to ascertain the law provided in the account agreement, as the lender could require the grantor (the account holder) to supply information on the account agreement to obtain credit from the lender relying on the funds credited to the account (see Secured Transactions Guide, chap. X, para. 50). To be effective for conflict-of-laws purposes, a designation must refer to the law of a State in which the deposit-taking institution is regularly engaged in the business of maintaining bank accounts. It should be noted that the State whose law is so designated may be different from the State in which the grantor's bank account is maintained.

509. If the applicable law cannot be determined as described in the preceding paragraph, option B provides for a series of rules along the lines of the default rules contained in article 5 of the Hague Securities Convention, which the enacting State may wish to insert in this article, if it decides to adopt option B of article 97. For

example, the enacting State may wish to consider inserting the following text as paragraph 3 of option B: “If the applicable law is not determined pursuant to paragraph 1 or 2, the applicable law is to be determined pursuant to the following rules: (a) If it is expressly and unambiguously stated in a written bank account agreement that the relevant deposit-taking institution entered into through a particular office, the law applicable is the law of the State in which that office is located; (b) If the applicable law is not determined under subparagraph (a), the applicable law is the law of the State under whose law the relevant deposit-taking institution is incorporated or otherwise organized at the time the written bank account agreement is entered into or, if there is no such agreement, at the time the bank account was opened; and (c) If the applicable law is not determined under either subparagraph (a) or subparagraph (b), the applicable law is the law of the State in which the relevant deposit-taking institution has its place of business, or, if the relevant deposit-taking institution has more than one place of business, its principal place of business, at the time the written bank account agreement is entered into or, if there is no such agreement, at the time the bank account was opened”.

Article 98. Third-party effectiveness of a security right in certain types of asset by registration

510. Article 98 is based on recommendation 211 of the Secured Transactions Guide (see chap. X, para. 34). This article is an exception to the conflict-of-laws rules on the third-party effectiveness of a security right in a negotiable instrument, negotiable document, right to payment of funds credited to a bank account or certificated non-intermediated security (but article 98 does not apply to uncertificated non-intermediated securities). Under articles 85, 97 and 100, the effectiveness against third parties of a security right in any of these assets is governed by the law of a State, which may be different from the State of the location of the grantor. However, under article 98, if the State of the location of the grantor recognizes registration of a notice as a method of third-party effectiveness for a security right in the types of asset covered in article 98, then the law applicable to third-party effectiveness by registration is the law of the State in which the grantor is located.

511. Therefore, with respect to these types of asset, a secured creditor may rely on the law of the location of the grantor to make its security right effective against third parties by registration, even if for these types of asset the applicable law might be different under the other conflict-of-laws rules of this chapter. However, if the priority rules of the applicable law are based on the priority rules of the Model Law, achieving third-party effectiveness by registration would only yield a lower-ranking priority in the case of a priority conflict with a competing secured creditor who achieved third-party effectiveness, for example, by possession in the case of a

negotiable instrument (see art. 46, para. 1, and para. 349 above), by the secured creditor becoming the account holder in the case of a right to payment of funds credited to a bank account (see art. 47, para. 1, and para. 353 above) or by possession in the case of a negotiable document or a certificated non-intermediated security (see arts. 49, para. 1, and 51, para. 1, and paras. 359 and 363 above, respectively). However, the security right with respect to which a notice was registered in the Registry under the law of the grantor's location would have priority over the right of: (a) the grantor's insolvency representative or the general body of creditors (subject to the applicable insolvency law; see arts. 35 and 36, and paras. 312-316 above); and (b) judgment creditors, if registration took place before a judgment creditor took the steps required to acquire a right in the encumbered assets (see art. 37, para. 1, and para. 317 above).

Article 99. Security rights in intellectual property

512. Article 99 is based on recommendation 248 of the Intellectual Property Supplement (see Intellectual Property Supplement, paras. 284-337). The effect of paragraph 1 is the following. If intellectual property is protected in a particular State, the law of that State will apply to the requirements to be met for the security right in that intellectual property to be considered as having been created and made effective against third parties, and as having priority over the rights of competing claimants. It should be noted that even with respect to intellectual property protected under an international convention, the *lex protectionis* is the law of the State party to the Convention under which the intellectual property is protected. For example, with respect to types of intellectual property that are subject to registration in a national, regional or international intellectual property registry (for example, patents and trademarks), the *lex protectionis* is the law of the State (including the rules promulgated by regional or international organizations) under whose authority the registry is maintained (see Intellectual Property Supplement, para. 297).

513. Paragraph 2 provides for an alternative way to create and make effective against certain third parties a security right in intellectual property. Under paragraph 2, the secured creditor may also utilize for these purposes the law of the State in which the grantor is located. The principal benefit of paragraph 2 is that a security right in a portfolio of intellectual property rights protected under the laws of different States may be created and made effective against third parties under a single law. An equally important benefit of paragraph 2 is that, if the security right has been made effective against the grantor's insolvency representative under the law of the State in which the grantor is located, an insolvency court in the enacting State will recognize the security right even if the third-party effectiveness requirements of all States in which the intellectual property is protected have not been fulfilled.

514. Paragraph 3 refers enforcement issues to the law of the State in which the grantor is located. This rule allows for the same law to be applied to all enforcement steps, even if they take place in different States, because it is unlikely that the grantor's location (in particular the place of its central administration) would change between any of those steps. In the rare case where there would be such a change, it is assumed that a court would refer to the law of the State in which the grantor is located at the time of commencement of the enforcement (see art. 88, and paras. 483-485 above).

Article 100. Security rights in non-intermediated securities

515. Article 100 introduces one general conflict-of-laws rule for security rights in equity securities and another for security rights in debt securities, without distinguishing between certificated and uncertificated or between traded and non-traded securities. Both of these rules refer all issues (i.e. the creation, third-party effectiveness, priority, enforcement and effectiveness against the issuer of a security right) to a single law. This approach provides greater certainty in the determination of the applicable law.

516. For non-intermediated equity securities, paragraph 1 designates the law of the constitution of the issuer as the law applicable to all issues. The term "equity" is not defined in the Model Law but it should be understood as referring to participation rights in the capital of the issuer. For a corporation or a similar legal person, equity securities consist of the shares in its capital. Similarly, for an entity which is not a legal person under its constitutive law (such as a general partnership in many States), equity securities consist of the rights of the persons (e.g. the partners) who are entitled to receive upon the liquidation of the entity the residual value of its assets after payment of its liabilities.

517. The law of the constitution of the issuer is the law under which it has been formed. For a corporation, this is relatively easy to ascertain; it is the law under which it has been incorporated. For a partnership, it is the law under which the partnership has been created. In federal States where the issuer may be constituted either under a federal law or a law of one of its territorial units, the Model Law does not provide specific criteria on the determination of the territorial unit which will be considered as the issuer's law where the issuer's law is a federal law and the law on secured transactions is that of a territorial unit. However, applying by analogy article 95, the internal conflict-of-laws rules of the federal State (or of the territorial unit which is the forum) should determine the territorial unit's law to be applicable to the issues falling under article 100 where all or some of these issues are not dealt with by the federal law of the constitution of the issuer.

518. For non-intermediated debt securities, paragraph 2 refers all issues to the law governing the securities. The law governing debt securities is the law selected by the parties as the law governing their contractual rights and obligations arising from these securities. In the absence of such a choice of law (which would be extremely rare for debt securities), the forum will determine the applicable law under its own conflict-of-laws rules. The Model Law does not deal with the question of whether the parties may select a governing law that has no connection with the issuance of the securities. This matter is left to the conflict-of-laws rules on contractual obligations of the forum State.

519. The term “debt securities” is not defined in the Model Law. The notion of debt is however well understood in most legal systems and denotes a payment obligation. In the context of debt securities, the obligation is generally to make payment of a sum of money. Bonds and debentures are debt securities, to the extent they come under the definition of securities in article 2, subparagraph (*hh*).

520. The distinction between equity and debt securities should be based on their characterization under corporate or enterprise law, and not under accounting or other law. Thus, preferred shares (i.e. shares that entitle the holder to a fixed dividend, whose payment takes priority over that of common share dividends) are treated as equity securities if they are so considered under the corporate or enterprise law of the issuer’s State even if under accounting or other rules of that State they are classified as liabilities. Likewise, subordinated debt securities (e.g. debt payable only after satisfaction of obligations owing to certain creditors) are treated as debt securities if they are so considered under the corporate or enterprise law of the issuer’s State even if they are viewed as equity securities under accounting or other law.

521. The concept of “debt securities” raises the following two questions: (*a*) the characterization of convertible debt securities; and (*b*) the effect of that characterization on the law applicable to a security right in that type of security. Convertible debt securities are debt securities that are convertible into equity securities at the option of their holder or issuer or upon the occurrence of a specified event.

522. Convertible debt securities should be characterized as debt securities because they constitute payment obligations as long as they are not converted into equity. This means that upon their issuance and until conversion, the law governing these securities will be the law applicable to the creation, third-party effectiveness, priority, enforcement and effectiveness against the issuer of a security right in such securities. The characterization of convertible debt securities for the purposes of article 100 may, however, change if and when they are converted into equity. The connecting factor then becomes the law of the constitution of the issuer. Therefore, upon being converted into equity, the law applicable to a security right in

convertible debt securities will be the law of the State under which the issuer has been constituted.

523. A consequence of the change from the law governing the securities to the issuer's law is that a security right in debt securities made effective against third parties under the law governing the securities might become ineffective against third parties after the change. Article 23 addresses the impact of a change in the applicable law and article 91 addresses a change in the connecting factor. However, strictly speaking, article 23 is not applicable to a change in the nature of non-intermediated securities; and article 91 only deals with the situation where the connecting factor is the location of the asset or the grantor. The enacting State may thus wish to draw from articles 23 and 91 and adopt rules dealing with the change on the basis of principles similar to those underlying articles 23 and 91 (see paras. 132, 133 and 490-493 above).

524. With respect to certificated equity or debt non-intermediated securities, article 98 introduces an exception to the general conflict-of-laws rules of article 100. If the law of the State in which the grantor is located recognizes registration of a notice as a method for achieving effectiveness against third parties of a security right in certificated non-intermediated securities, the law of that State is also the law applicable to the third-party effectiveness of the security right in this type of asset by registration (see paras. 510 and 511 above).

Chapter IX. Transition

Introduction

525. The introduction of any new law requires fair and efficient transition rules (see Secured Transactions Guide, chap. XI, paras. 1-3). This is the purpose of this chapter. First, it provides that the law formerly governing rights that fall within the scope of the new secured transactions law (the “prior law”; see art. 102, para. 1 (a)) is repealed (see art. 101). Second, it provides for the general application of the new law to all security rights (see art. 102, para. 2), including security rights that were created while the prior law was still in force (“prior security rights”; see art. 102, para. 1 (b)), but continue to exist after the new secured transactions law enters into force. Third, it preserves the exceptional application of prior law in circumstances where no new third-party rights are implicated (see arts. 103-105, and paras. 534-542 below). Fourth, it provides a transition period for the holders of prior security rights to comply with the third-party effectiveness requirements of the new law (see art. 106, and paras. 544-546 below). Finally, it sets a date (or the mode of setting the date) on which the new law goes into effect (see art. 107, and paras. 547 and 548 below).

Article 101. Amendment and repeal of other laws

526. The Model Law provides a comprehensive legal framework to govern security rights in the types of asset within its scope under article 1, replacing rather than merely supplementing the prior law. Accordingly, paragraph 1 requires the enacting State to list the laws to be repealed upon entry into force of the new law under article 107. The way in which the repeal is effectuated will depend on the form of the prior law. Where the prior law is set out in a free-standing statute or combination of statutes, it can be repealed in its entirety. Where the prior law is contained in statutes that also address other topics, the enacting State must specify which provisions are to be repealed and which are to be retained or amended. Where all or part of the prior law is based on judicial opinions (as may be the case, for example, in common law systems), the effect of the new secured transactions law typically will be to override the rules derived from the prior case law without the need for the enacting State to take any explicit repealing measures.

527. Secured transactions law interacts with many other laws (e.g. civil procedure, judgment enforcement, insolvency, property and taxation laws). These other laws may contain provisions that refer to or are premised on the enacting State's prior law. Accordingly, paragraph 2 provides for the enacting State to amend these provisions to the extent needed to align them with the terminology and the provisions of its new law.

528. Like the other articles of the Model Law, article 101 takes effect only when the new law enacting the Model Law enters into force under article 107. Accordingly, until that date, the provisions listed for repeal or amendment in this article remain in effect.

Article 102. General applicability of this Law

529. Paragraph 1 of this article defines two terms used in this chapter. Paragraph 1 (a) defines the term "prior law" to mean the law that applied to "prior security rights" (see para. 530 below) before the entry into force of the new law. This definition makes it clear that the term "prior law" refers to the law designated by the conflict-of-laws rules of the enacting State as those rules existed before the entry into force of the new law. It follows that the prior law may be: (a) the law of the enacting State or of another State; and (b) a different law than that which would apply under the conflict-of-laws rules of the Model Law if the enacting State's prior conflict-of-laws regime used a different connecting factor. It should be noted that, even though it is expressed in the singular, the term "prior law" refers to all relevant sources of the applicable prior substantive law wherever they may be reflected (e.g. in a civil or commercial code, a special statute, case law or a combination of any of these sources).

530. Paragraph 1 (b) defines "prior security right" (a term referred to in the definition of the term "prior law"; see para. 539 above) as a right created by an agreement entered into before the entry into force of the new law that the new law treats as a security right. For example, a seller's or financial lessor's retention-of-title right would be a prior security right because it is characterized as such under the functional concept of security right adopted by the Model Law (see art. 2, subpara. (kk), and para. 68 above) even if prior law did not characterize it as a security right.

531. It should be noted that a security right in future assets acquired by the grantor after the new law enters into force would be a prior security right if it was provided for in an agreement entered into before the entry into force of the new law even though the creation requirements of the new law are not satisfied (see art. 104, para. 2). This presupposes that prior law permitted the creation of a

security right in future assets; if it did not, then no prior security right could exist in future assets.

532. Paragraph 2 is based on recommendation 228 (second sentence) of the Secured Transactions Guide (see chap. XI, paras. 7-12). It states that, upon its entry into force under article 107, the new law applies, as a general rule, to all security rights within its scope, including prior security rights. This general rule ensures that the enacting State enjoys the economic benefits of the new law with immediate effect and avoids the complexity and conflict that would result from attempting to apply discrete laws to prior and new security rights.

533. The transition to any new legal regime requires that pre-existing rights are appropriately accommodated. Thus, paragraph 2 also provides that the general applicability of the new law to prior security rights is subject to the other provisions of this chapter. These other provisions preserve the exceptional application of prior law to prior security rights where no third-party rights are affected (see art. 104), or where the rights of a holder of a prior security right and competing claimants have already vested (see arts. 103 and 106); they also provide a transition period for the holders of prior security rights to conform to the third-party effectiveness requirements of the new law (see art. 105, and paras. 538-543 below).

Article 103. Applicability of prior law to matters that are the subject of proceedings commenced before the entry into force of this Law

534. Article 103 is based on recommendation 229 of the Secured Transactions Guide (see chap. XI, paras. 13-16). It introduces two exceptions to the general rule in article 102, paragraph 2, that the new law applies to all security rights within its scope, including prior security rights. Paragraph 1 provides for the continued application of prior law to a matter with respect to a prior security right that is the subject of judicial or arbitral proceedings that were commenced before the new law entered into force (except enforcement proceedings separately addressed in art. 103, para. 2), regardless of whether those proceedings involve the secured creditor and the grantor or the debtor, the secured creditor and a competing claimant, or the secured creditor and another third party. However, prior law applies only to the matter that is the subject of the prior proceedings. Under the general rule in article 102, paragraph 2, the new law will apply to a separate matter that is the subject of proceedings that are commenced after the new law enters into force even if it relates to the same security agreement.

535. Paragraph 2 provides that, if enforcement of a prior security right is commenced before the entry into force of the new law, the secured creditor may

continue enforcement in accordance with prior law (what constitutes “enforcement” under prior law would need to be assessed by reference to prior law), or may choose to enforce its security right in accordance with the new law (what constitutes “enforcement” under the new law is addressed in chapter VII of the Model Law). Paragraph 2 applies if “any step” has been taken to enforce a prior security right before the entry into force of the new law. Thus, for example, if the secured creditor has already obtained possession of an encumbered asset in accordance with prior law when the new law enters into force, it may dispose of the encumbered asset and distribute its proceeds under the prior law or proceed as to those matters under the new law notwithstanding paragraph 1.

Article 104. Applicability of prior law to the creation of a prior security right

536. Article 104 is based on recommendation 230 of the Secured Transactions Guide (see chap. XI, paras. 17-19). It sets out an exception to general applicability of the new law to prior security rights under article 102, paragraph 2. Paragraph 1 provides that prior law determines whether a right that was created under an agreement entered into before the new law enters into force that would be a security right under the new law was created effectively. Paragraph 2 confirms that a prior security right that was effectively created under prior law remains effective between the parties after the new law enters into force even if the requirements for creation under the new law are not satisfied. This approach avoids the retroactive invalidation of prior security rights that were created in conformity with the law applicable to them when they were created. It also dispenses with the need for the secured creditor to obtain the cooperation of the grantor to take whatever additional steps may be necessary to conform to the creation requirements of the new law. Such cooperation may not be forthcoming from a grantor that has already received all the credit intended to be secured by the prior security right.

537. The creation requirements of the new law are relatively minimal (see art. 6). Consequently, it will rarely be the case that a security right created in conformity with prior law would not also satisfy the creation requirements of the new law. An example of a possible exception would be a prior security right created in accordance with a rule of prior law that allowed the creation of a security right by an oral agreement even in the absence of possession of the encumbered asset by the secured creditor. In this example, paragraph 2 would preserve the effectiveness of the prior security right between the parties even though the new law requires a non-possessory security right to be created by a written security agreement signed by the grantor (see art. 6, para. 3).

Article 105. Transitional rules for determining the third-party effectiveness of a prior security right

538. Article 105 is based on recommendation 231 of the Secured Transactions Guide (see chap. XI, paras. 20-22). It introduces a qualified exception to the general applicability of the third-party effectiveness requirements of the new law to prior security rights under article 102, paragraph 2. Under paragraph 1, a prior security right that was made effective against third parties under prior law remains effective against third parties for a transitional period specified by the enacting State after entry into force of the new law even if the conditions for third-party effectiveness under the new law have not been satisfied. The transitional period expires at the earlier of the time when the third-party effectiveness of the security right would have ceased under prior law (see para. 1 (a)) or the time when the transitional period expires (see para. 1 (b)). The length of the transitional period should be sufficient to allow secured creditors to familiarize themselves with the new law and take the steps required by the new law to make their security rights effective against third parties (e.g. one to two years; for the preparatory steps to be taken into account in determining when the new law is to enter into force, see para. 548 below).

539. The following examples illustrate the operation of paragraph 1. Suppose that a prior security right took effect against third parties under prior law on the conclusion of the security agreement without the need for the creditor to register or take any other additional step such as possession. The effect of paragraph 1 is to preserve the third-party effectiveness of the prior security right for the purposes of the new law after it comes into force until the expiration of the period specified in paragraph 1 (b) (e.g. one to two years). Alternatively, suppose that the applicable prior law instead required public registration for third-party effectiveness, and the holder of the prior security right duly registered, but the registration period under prior law would have expired six months after the new law came into force. In this situation, paragraph 1 (a) would apply with the result that the third-party effectiveness of the prior security right would be preserved only for a period of six months after the new law entered into force.

540. Under paragraph 2, the third-party effectiveness of a prior security right that would otherwise cease to be effective against third parties under paragraph 1 is preserved if the secured creditor takes the appropriate steps under the new law to achieve third-party effectiveness before the expiration of the relevant transition period in paragraph 1. In that event, the prior security right is treated as continuously effective against third parties from the time when it was first made effective against third parties under prior law. It follows that the time of third-party effectiveness under prior law will be treated as the relevant time for determining the priority of the security right against competing claimants for the purposes of the priority rules of the new law that turn on the time of third-party effectiveness.

541. Paragraph 3 addresses the situation where the requirements of the new law for third-party effectiveness are not satisfied until after the expiration of the transition period in paragraph 1, leaving a gap between the expiration of third-party effectiveness under paragraph 1 and the achievement of third-party effectiveness under the new law. In this case, paragraph 3 provides that the security right is effective against third parties only from the time it is made effective against third parties under the new law. It follows that the priority of the prior security right, for the purposes of the rules of the new law that determine priority by reference to the time of third-party effectiveness, will date only from that time.

542. A prior security right typically will be made effective against third parties under the new law by registration of a notice in the Registry (see art. 18, and para. 123 above). The Model Law requires the grantor's authorization for registration but provides that the conclusion of a written security agreement automatically constitutes sufficient authorization for the registration of a notice covering the assets described in the agreement without the need for an express authorization clause (see art. 2 of the Model Registry Provisions, and paras. 151-157 above). In line with this rule, paragraph 4 confirms that a written agreement between a grantor and a secured creditor creating the prior security right constitutes sufficient authorization even if the agreement was concluded before the entry into force of the new law.

543. Paragraph 5 makes explicit a point that is implicit in paragraph 2. It provides that, if a prior security right that was made effective against third parties under prior law by registration remains continuously effective against third parties under paragraph 2, the priority rules of the new law that depend on the time of registration are to be applied using the time of registration under prior law.

Article 106. Application of prior law to the priority of a prior security right as against the rights of competing claimants arising under prior law

544. Article 106 provides an exception to the general rule in article 102, paragraph 2, that the new law applies to all security rights, including prior security rights. In the circumstance described in article 106, the priority of a prior security right as against competing claimants is determined by application of prior law.

545. Application of the priority rules of prior law appropriately respects the settled expectations of secured creditors and competing claimants provided that the priority competition does not involve the rights of new competing claimants that arose after the new law became effective. Accordingly, paragraph 1 makes the application of prior law subject to the caveat that the priority status of the prior security

right and the rights of competing claimants must not have changed since the entry into force of the new law.

546. Paragraph 2 provides guidance on when the priority status of a prior security right has changed within the meaning of paragraph 1 to require instead application of the priority rules of the new law in accordance with the general rule in article 102, paragraph 2. The effect of paragraph 2 is to make the priority rules of the new law applicable if the prior security right: (a) was created under prior law but was not made effective against third parties under prior law but only under the new law (see para. 2 (b)); or (b) it was made effective against third parties under prior law but continuity of third-party effectiveness was not preserved before the expiration of the transition period set out in article 105, paragraph 1 (see para. 2 (a)).

Article 107. Entry into force of this Law

547. Article 107 is based on recommendation 228 of the Secured Transactions Guide (see chap. XI, paras. 4-6). It requires the enacting State to specify the date when, or the mechanism according to which, the new law will enter into force. The Model Law does not recommend a particular approach, leaving this matter to the enacting State. For example, the new law might specify that it is to enter into force on a specified date or on a date to be specified by a separate decree. The placement of this article in the law of the law enacting State and its precise formulation will also depend on whether the new law is contained in a stand-alone statute or incorporated into a general civil or commercial code.

548. In determining when the new law will enter into force, careful consideration should be given both to obtaining the economic benefits of the new law as soon as possible and to minimizing disruptions that may be caused by significant changes in secured transactions practice resulting from the new law. Inasmuch as the new law will have been chosen because it is an improvement over the prior law, it should come into force as soon as is possible after the text of the new law is final and the registry system required to support it is operational. However, some lead time is necessary in order to, inter alia: (a) publicize the existence of the new law; (b) enable potential registry users to familiarize themselves with the operation of the Registry, including its registration and search requirements, and to undertake the necessary preparations to use the registry services; (c) educate participants in the secured transactions system about the effect of the new law and the transition from the prior to the new law and enable them to prepare for compliance with the new rules and to develop new forms of security agreements and other required documents; and (d) educate other affected constituents, for example, buyers, lessees, judgment creditors and insolvency representatives, on the impact of the new law on their rights.

Annex I

UNCITRAL MODEL LAW ON SECURED TRANSACTIONS: DECISION OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW AND GENERAL ASSEMBLY RESOLUTION 71/136

A. Decision of the Commission

At its 1032nd meeting on 1 July 2016, the Commission adopted the following decision:

“The United Nations Commission on International Trade Law,

“Recalling General Assembly resolution 2205 (XXI) of 17 December 1966, which established the United Nations Commission on International Trade Law with the purpose of furthering the progressive harmonization and unification of the law of international trade in the interests of all peoples, in particular those of developing countries,

*“Recalling also General Assembly resolutions 56/81 of 12 December 2001, 63/121 of 11 December 2008, 65/23 of 6 December 2010 and 68/108 of 16 December 2013 in which the General Assembly recommended that States consider or continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001)¹⁸ and giving favourable consideration to the *UNCITRAL Legislative Guide on Secured Transactions* (2007),¹⁹ the *Supplement on Security Rights in Intellectual Property*²⁰ and the *UNCITRAL Guide on the Implementation of a Security Rights Registry*,²¹ respectively,*

“Further recalling that, at its forty-sixth session, in 2013, it entrusted Working Group VI (Security Interests) with the preparation of a model law on secured

¹⁸ General Assembly resolution 56/81, annex. Also available as United Nations publication, Sales No. E.04.V.14.

¹⁹ United Nations publication, Sales No. E.09.V.12.

²⁰ United Nations publication, Sales No. E.11.V.6.

²¹ United Nations publication, Sales No. E.14.V.6.

transactions based on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions (2007) and consistent with all texts prepared by UNCITRAL on secured transactions,²²

“*Noting* that the Working Group devoted six sessions, from 2013 to 2016, to the preparation of the draft model law on secured transactions (the ‘draft Model Law’),²³

“*Further noting* that, at its forty-eighth session, in 2015, the Commission approved the substance of the registry-related provisions of the draft Model Law,²⁴

“*Further noting* with satisfaction that the draft Model Law is based on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions and consistent with all texts prepared by UNCITRAL on secured transactions, and with those texts thus provides comprehensive guidance to States with respect to legal and practical issues that need to be addressed when implementing a modern secured transactions regime,

“*Recognizing* that an efficient secured transactions regime with a publicly accessible security rights registry of the kind provided for in the draft Model Law is likely to increase access to affordable secured credit and thus promote economic growth, sustainable development, the rule of law and financial inclusion, as well as assist in combating poverty,

“*Recognizing also* that the harmonization of national secured transactions regimes and registries on the basis of the draft Model Law is likely to increase the availability of secured credit across national borders and thus facilitate the development of international trade, which, if achieved on the basis of equality and mutual benefit to all States, is an important element in promoting friendly relations among States,

“*Recognizing further* that secured transactions law reform could not be effectively implemented without the establishment of an efficient, publicly accessible security rights registry where information about the potential existence of a security right in movable assets may be registered, and that States urgently need guidance with respect to the establishment and operation of such registries,

²² *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17 (A/68/17)*, paras. 194 and 332.

²³ For the reports of those sessions of the Working Group, see A/CN.9/796, A/CN.9/802, A/CN.9/830, A/CN.9/836, A/CN.9/865 and A/CN.9/871.

²⁴ *Official Records of the General Assembly, Seventieth Session, Supplement No. 17 (A/70/17)*, para. 214.

“Expressing its appreciation to international intergovernmental and non-governmental organizations active in the field of secured transactions law reform for their participation in and support for the development of the draft Model Law,

“Having considered the draft Model Law at its forty-ninth session, in 2016,

“Drawing attention to the fact that the text of the draft Model Law was circulated for comment before the forty-ninth session of the Commission to all Governments invited to attend sessions of the Commission and the Working Group as members and observers and that the comments received were before the Commission at its forty-ninth session,²⁵

“Considering that the draft Model Law has received sufficient consideration and has reached the level of maturity for it to be generally acceptable to States,

“1. Adopts the UNCITRAL Model Law on Secured Transactions, consisting of the text contained in documents A/CN.9/884 and addenda 1-4, with amendments adopted by the Commission at its forty-ninth session, and authorizes the Secretariat to edit and finalize the text of the UNCITRAL Model Law on Secured Transactions pursuant to the deliberations of the Commission at that session;

“2. Requests the Secretary-General to publish the UNCITRAL Model Law on Secured Transactions, including electronically and in the six official languages of the United Nations, and to disseminate it broadly to Governments and other interested bodies;

“3. Recommends that all States give favourable consideration to the UNCITRAL Model Law on Secured Transactions when revising or adopting legislation relevant to secured transactions, and invites States that have used the Model Law to advise the Commission accordingly;

“4. Also recommends that, where necessary, States continue giving favourable consideration to the UNCITRAL Guide on the Implementation of a Security Rights Registry when revising relevant legislation, administrative regulations or guidelines, and to the UNCITRAL Legislative Guide on Secured Transactions and the Supplement on Security Rights in Intellectual Property when revising or adopting legislation relevant to secured transactions, and invites States that have used the guides to advise the Commission accordingly;

²⁵ A/CN.9/886, A/CN.9/887 and A/CN.9/887/Add.1.

“5. *Also recommends* that all States continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade, the principles of which are also reflected in the UNCITRAL Model Law on Secured Transactions, and the optional annex of which refers to the registration of notices with regard to assignments.”

B. General Assembly resolution 71/136

At its 62nd plenary meeting, on 13 December 2016, the General Assembly adopted on the basis of the report of the Sixth Committee (A/71/507), the following resolution:

The General Assembly,

Recalling its resolution 2205 (XXI) of 17 December 1966, by which it established the United Nations Commission on International Trade Law with a mandate to further the progressive harmonization and unification of the law of international trade and in that respect to bear in mind the interests of all peoples, in particular those of developing countries, in the extensive development of international trade,

Recalling also its resolutions 56/81 of 12 December 2001, 63/121 of 11 December 2008, 65/23 of 6 December 2010 and 68/108 of 16 December 2013, in which it recommended that States consider or continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade²⁶ and giving favourable consideration to the UNCITRAL Legislative Guide on Secured Transactions, the Supplement on Security Rights in Intellectual Property and the UNCITRAL Guide on the Implementation of a Security Rights Registry, respectively,

Recalling further that, at its forty-sixth session, in 2013, the Commission entrusted Working Group VI (Security Interests) with the preparation of a model law on secured transactions based on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions and consistent with all texts prepared by the Commission on secured transactions,²⁷

Noting that Working Group VI devoted six sessions,²⁸ from 2013 to 2016, to the preparation of the Model Law on Secured Transactions,

²⁶ Resolution 56/81, annex.

²⁷ *Official Records of the General Assembly, Sixty-eighth Session, Supplement No. 17 (A/68/17)*, paras. 194 and 332.

²⁸ See A/CN.9/796, A/CN.9/802, A/CN.9/830, A/CN.9/836, A/CN.9/865 and A/CN.9/871.

Noting also that, at its forty-eighth session, in 2015, the Commission approved the substance of the registry-related provisions of the Model Law,²⁹

Noting with satisfaction that the Model Law is based on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions and consistent with all texts prepared by the Commission on secured transactions, and with those texts thus provides comprehensive guidance to States with respect to legal and practical issues that need to be addressed when implementing a modern secured transactions regime,

Recognizing that an efficient secured transactions regime with a publicly accessible security rights registry of the kind provided for in the Model Law is likely to increase access to affordable secured credit and thus promote economic growth, sustainable development, the rule of law and financial inclusion, as well as assist in combating poverty,

Recognizing also that the harmonization of national secured transactions regimes and registries on the basis of the Model Law is likely to increase the availability of secured credit across national borders and thus facilitate the development of international trade, which, if achieved on the basis of equality and mutual benefit to all States, is an important element in promoting friendly relations among States,

Recognizing further that secured transactions law reform could not be effectively implemented without the establishment of an efficient, publicly accessible security rights registry where information about the potential existence of a security right in movable assets may be registered, and that States urgently need guidance with respect to the establishment and operation of such registries,

Convinced that the Model Law will contribute to greater legal certainty in the exercise of international commercial activities for the benefit of all States, particularly developing countries and States with economies in transition,

Noting with appreciation that all States and interested international organizations were invited to participate in the preparation of the draft Model Law at all the sessions of the Working Group and at the forty-eighth and forty-ninth sessions of the Commission, either as members or as observers, and that comments received after circulation of the text of the Model Law to all Governments were before the Commission at its forty-ninth session,³⁰

²⁹ Official Records of the General Assembly, Seventieth Session, Supplement No. 17 (A/70/17), para. 214.

³⁰ See A/CN.9/886 and A/CN.9/887 and Add.1.

Expressing its appreciation to international intergovernmental and non-governmental organizations active in the field of secured transactions law reform for their participation in and support for the development of the Model Law,

1. *Expresses its appreciation* to the United Nations Commission on International Trade Law for completing and adopting the Model Law on Secured Transactions;³¹
2. *Requests* the Secretary-General to publish the Model Law, including electronically, in the six official languages of the United Nations, and to disseminate it broadly to Governments and other interested bodies;
3. *Recommends* that all States give favourable consideration to the Model Law when revising or adopting legislation relevant to secured transactions, and invites States that have used the Model Law to advise the Commission accordingly;
4. *Also recommends* that, where necessary, States continue to give favourable consideration to the UNCITRAL Guide on the Implementation of a Security Rights Registry when revising relevant legislation, administrative regulations or guidelines, and to the UNCITRAL Legislative Guide on Secured Transactions and the Supplement on Security Rights in Intellectual Property when revising or adopting legislation relevant to secured transactions, and invites States that have used the guides to advise the Commission accordingly;
5. *Further recommends* that all States continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade, the principles of which are also reflected in the Model Law, and the optional annex to which refers to the registration of notices with regard to assignments.

³¹ Official Records of the General Assembly, Seventy-first Session, Supplement No. 17 (A/71/17), chap. III, sect. A.

Annex II

Guide to Enactment of the UNCITRAL Model Law on Secured Transactions: Decision of the United Nations Commission on International Trade Law

At its 1067th meeting, on 20 July 2017, the Commission adopted the following decision:

“The United Nations Commission on International Trade Law,

“Recalling General Assembly resolution 2205 (XXI) of 17 December 1966, which established the United Nations Commission on International Trade Law with the purpose of furthering the progressive harmonization and unification of the law of international trade in the interests of all peoples, in particular those of developing countries,

*“Recalling also General Assembly resolutions 56/81 of 12 December 2001, 63/121 of 11 December 2008, 65/23 of 6 December 2010 and 68/108 of 16 December 2013, in which the General Assembly recommended that States consider or continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade (New York, 2001)³² and giving favourable consideration to the *UNCITRAL Legislative Guide on Secured Transactions* (2007),³³ the *Supplement on Security Rights in Intellectual Property*³⁴ and the *UNCITRAL Guide on the Implementation of a Security Rights Registry*,³⁵ respectively,*

³²General Assembly resolution 56/81, annex. Also available as United Nations publication, Sales No. E.04.V.14.

³³United Nations publication, Sales No. E.09.V.12.

³⁴United Nations publication, Sales No. E.11.V.6.

³⁵United Nations publication, Sales No. E.14.V.6.

“Further recalling that, at its forty-ninth session, in 2016, the Commission adopted the UNCITRAL Model Law on Secured Transactions (the ‘Model Law’)³⁶ and that the General Assembly, in its resolution 71/136, recommended the Model Law for use by States,

“Being convinced that the overarching benefits of the Model Law include an increase in access to affordable credit, the facilitation of the development of international trade and greater legal certainty in the exercise of international commercial activities,

“Noting that a number of issues were referred to a draft guide to enactment of the Model Law (the ‘draft Guide to Enactment’) during the deliberations of the Model Law and that, at its forty-ninth session, in 2016, the Commission agreed to give Working Group VI (Security Interests) up to two sessions to complete its work on the draft Guide to Enactment and submit it to the Commission for final consideration and adoption at its fiftieth session, in 2017,³⁷

“Noting also that the Working Group devoted two sessions, in 2016 and 2107, to the preparation of the draft Guide to Enactment,³⁸ and that, at its thirty-first session, in 2017, the Working Group approved the substance of the draft Guide to Enactment and decided to submit it to the Commission for final consideration and approval at its fiftieth session,³⁹

“Further noting with satisfaction that the draft Guide to Enactment provided background and explanatory information that could assist States in revising or adopting legislation relevant to secured transactions on the basis of the Model Law,⁴⁰ and thus a guide to enactment of the Model Law would be an extremely important text for the implementation and interpretation of the Model Law,⁴¹

“Expressing its appreciation to international intergovernmental and non-governmental organizations active in the field of secured transactions law reform for their participation in and support for the development of the Model Law and the draft Guide to Enactment,

³⁶*Official Records of the General Assembly, Seventy-first Session, Supplement No. 17 (A/71/17)*, para. 119. For the text of the Model Law, see United Nations publication (ISBN: 978-92-1-133856-0), available at http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf.

³⁷*Ibid.*, para. 122.

³⁸For the reports of those sessions of the Working Group, see A/CN.9/899, and A/CN.9/904.

³⁹A/CN.9/904, para. 135.

⁴⁰*Official Records of the General Assembly, Seventy-first Session, Supplement No. 17 (A/71/17)*, para. 121.

⁴¹*Ibid.*, para. 122.

“*Having considered* the draft Guide to Enactment at its fiftieth session, in 2017,

“*Considering* that the draft Guide to Enactment has received sufficient consideration and has reached the level of maturity for it to be generally acceptable to States,

“1. *Adopts* the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions, consisting of the text contained in documents A/CN.9/914 and Addenda 1-6, with amendments adopted by the Commission at its fiftieth session, and authorizes the Secretariat to edit and finalize the text of the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions pursuant to the deliberations of the Commission at that session;

“2. *Requests* the Secretary-General to publish the Guide to Enactment of the UNCITRAL Model Law on Secured Transactions, including electronically and in the six official languages of the United Nations, and to disseminate it broadly to Governments and other interested bodies;

“3. *Recommends* that all States give favourable consideration to the UNCITRAL Model Law on Secured Transactions, taking also into account the information in the Guide to Enactment, when revising or adopting legislation relevant to secured transactions, and invites States that have used the Model Law to advise the Commission accordingly;

“4. *Also recommends* that, where necessary, States continue giving favourable consideration to the *UNCITRAL Guide on the Implementation of a Security Rights Registry* when revising relevant legislation, administrative regulations or guidelines, and to the *UNCITRAL Legislative Guide on Secured Transactions* and the *Supplement on Security Rights in Intellectual Property* when revising or adopting legislation relevant to secured transactions, and invites States that have used the guides to advise the Commission accordingly;

“5. *Also recommends* that all States continue to consider becoming parties to the United Nations Convention on the Assignment of Receivables in International Trade, the principles of which are also reflected in the UNCITRAL Model Law on Secured Transactions, and the optional annex of which refers to the registration of notices with regard to assignments.”



