

# AMERICAN BANKRUPTCY INSTITUTE JOURNAL

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## UNCITRAL Legislative Guide on Secured Transactions: An Introduction and Overview

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As some readers may be aware, in December 2007, the main body of the United Nations Commission on International Trade Law (UNCITRAL) adopted the Legislative Guide on Secured Transactions (Guide), which deals with agreements between credit institutions (and other credit providers) and businesses or individuals.<sup>1</sup> The Guide is intended to assist countries (states), particularly emerging market states, that seek to develop a modern secured transactions law or to reform an existing credit law.<sup>2</sup> The Guide is the result of a realization that international secured credit law is based on multiple statutes in multiple jurisdictions that leave a great deal of uncertainty for participants, which, among other things, translates into credit at high costs or even less or no credit.<sup>3</sup>



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The Guide's main objectives are to facilitate secured financing with respect to personal property, enhance the amount of credit that can be made available and reduce the costs of such credit, all of which are particularly important given the current macroeconomic climate. It seeks to accomplish these objectives by providing a modern secured-transactions scheme that should lead to a greater harmonization of secured transactions law

<sup>1</sup> A complete draft (unpublished) version of the Guide may be obtained from the UNCITRAL Web site at [www.uncitral.org/uncitral/en/uncitral\\_texts/security.html](http://www.uncitral.org/uncitral/en/uncitral_texts/security.html).

<sup>2</sup> Guide, Introduction A.1.

<sup>3</sup> *Spiros v. Bazinas*, "Key Policy Issues of the UNCITRAL Draft Legislative Guide on Secured Transactions," available at [www.bwg.at/bwg/bwg\\_2007.nsf/0/164f5143a3b9b2b1c12573a30042ecde/\\$FILE/Bazinas-2.pdf](http://www.bwg.at/bwg/bwg_2007.nsf/0/164f5143a3b9b2b1c12573a30042ecde/$FILE/Bazinas-2.pdf).

### About the Author

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throughout the world and should positively impact international trade.<sup>4</sup> This article will provide an introduction and discussion on some of the key points addressed and recommended by the Guide.

Each chapter of the Guide generally contains two parts: (1) commentary, which provides an analysis of important issues and addresses dealing with such issues in developing legislation; and (2)

(movable) property created on a consensual basis (*i.e.*, by agreement)<sup>6</sup> and covers creation of security interests in tangible goods, such as inventory and equipment, but also deals with security rights in intangible goods, such as receivables, negotiable instruments, negotiable documents, rights to payment of funds credited to bank accounts and after-acquired property.<sup>7</sup> It excludes security rights in real estate, securities, financial contracts, aircraft, railway rolling stock, space objects, ships and any other category of mobile equipment if it is covered by a national law or international law agreement to which the state is a party.<sup>8</sup>

The Guide generally applies to security rights in intellectual property (IP) so long as it is not inconsistent with national law or international agreements

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recommendations, which are detailed and specific resolutions of the issues set forth in the commentary. It predominantly follows Article 9 of the UCC, as well as several other similar laws in Canada and New Zealand; however, it uses some terminology that is slightly different from Article 9 of the UCC.<sup>5</sup> For example, the Guide uses the term "security rights" for security interests; debtors that grant security rights are called "grantors;" and collateral is referred to as "encumbered assets."

### Scope

Broadly speaking, the Guide deals with security rights in certain personal

to which the state is a party.<sup>9</sup> The reason for this approach to IP is that it could not be entirely excluded as a property class since many types of secured financing usually include security in IP rights.<sup>10</sup> The interaction among the Guide, secured transaction law and IP law is the subject of additional future work by UNCITRAL.

### Creation of Security Rights

The Guide states that a law should provide that a security right is created by an agreement between the grantor and the secured creditor.<sup>11</sup> It proposes flexibility with respect to what is

<sup>6</sup> Recommendation 2.

<sup>7</sup> Recommendation 2(b).

<sup>8</sup> Recommendation 4.

<sup>9</sup> Recommendation 4.

<sup>10</sup> *Bazinas*, *supra* at 5.

<sup>11</sup> Recommendation 13.

considered a “writing” as the basis for a security agreement and even includes recommendations for permitting electronic communications to serve as security agreements.<sup>12</sup> The Guide requires, at a minimum, that a security agreement:

1. Reflect the intent of the parties to create a security right;
2. Identify the secured creditor and the grantor;
3. Describe the secured obligation;
4. Describe the encumbered assets so as to reasonably identify such assets; and
5. State the maximum monetary amount for which the security right may be enforced, if the state determines that it is helpful to facilitate subordinate lending.<sup>13</sup>

The security right is created immediately under the security agreement in an asset with respect to which the grantor has rights or the power to encumber at the time of execution of the agreement.<sup>14</sup> With respect to assets that the grantor acquires rights to or the power to encumber after the parties enter into a security agreement (after-acquired property), the security right is created at the time the grantor obtains such rights or powers.<sup>15</sup> A security right is created and effective as between the grantor and the secured creditor if the necessary requirements are met under the Guide for the security agreement.

## Perfection and Priority

As in an Article 9 UCC jurisdiction, the Guide provides that an additional act is necessary so as to make a security right effective as against third parties (*i.e.*, perfection). It also provides a variety of acts that accomplish this perfection, including registration of the security right in a general registry,<sup>16</sup> or another act, such as transfer of possession of a tangible encumbered asset.<sup>17</sup> The recommendation for a central filing system is a key component of the Guide, as well as its goal of establishing a practical system in order to efficiently determine priorities among competing security rights. In order to perfect most types of security rights under the Guide, states should enact a law that creates a filing registry and sets forth clear and concise guides to registration and searching procedures, and that information about the existence and role of the registry shall be widely

disseminated.<sup>18</sup> Registration should be effected by filing a notice with the registry that contains the following limited information:

1. Identify the grantor and secured creditor;
2. A description of the encumbered assets covered by the notice (which should be the same as that required for the security agreement);
3. Duration of the registration; and
4. The maximum monetary amount for which the security right may be enforced, if the state determines that it is helpful to facilitate subordinate lending.<sup>19</sup>

The final requirement is left up to the state because there are two competing views on that particular point. One view is that providing the maximum monetary amount facilitates subordinate lending, thereby maximizing availability to credit, while the other view is that such a statement will lead to parties including inflated amounts in notices, thereby actually limiting the amount of credit available for potential subordinate creditors.<sup>20</sup> Essentially, the registration notice contemplated by the Guide is the same as a UCC Form-1 financing statement.

The registration system is important because it recognizes the importance of the first-to-file approach in UCC Article 9 jurisdictions in determining priority among creditors, which is another key component of the Guide. For this reason, it adopts a similar first-to-file (“first-to-register” under the Guide) approach in its priority rules for registered security rights.<sup>21</sup> This means that as between two registered security rights, the one that registered first has priority over the later registered security right. A security right in a future asset or after-acquired property and proceeds of encumbered assets is entitled to priority based on the time of registration, not the time that such property or proceed is acquired or comes into existence.<sup>22</sup> The most poignant exceptions to the first-to-register rules involve security rights that are perfected by possession,<sup>23</sup> filing with a specialized registry or notation on certificates of title,<sup>24</sup> or certain acquisition security rights.<sup>25</sup> However, a majority of the security rights provided in the Guide

requires perfection by notice registration, and thus fall under the first-to-register concept. Furthermore, knowledge of the existence of a security right on the part of a competing claimant does not affect priority.<sup>26</sup> A summary of some of the Guide’s notable additional priority rules is as follows:

1. Between two rights where no registration exists and no other perfection method for effectiveness is used, none has priority and they share a *pro rata* priority position;<sup>27</sup>
2. Between a registered security right and the right of a buyer of the encumbered assets in the ordinary course of business, the buyer has priority provided he does not have notice that the sale violates the rights of the secured creditor;<sup>28</sup>
3. Between a registered security right and a preferential claim of creditors that provided services with respect to an encumbered asset (*e.g.*, repairing, storing, etc.), the preferential claims have priority up to the reasonable value of the services provided;<sup>29</sup> and
4. Between a registered security right and a supplier’s reclamation claim, the right to reclaim is subordinate to a security right that was made effective before the supplier exercised its right.<sup>30</sup>

The also Guide embraces the concept of subordination of rights by providing that “a competing creditor entitled to priority may at any time subordinate its priority unilaterally or by agreement in favor of any existing or future claimant,”<sup>31</sup> which can help grantors to maximize access to credit and afford all parties greater flexibility in structuring complex enterprise financing.

## Enforcement

The Guide does not specifically define “default” and simply leaves it up to the parties to define the term in the security agreement. However, it does provide recommendations for enforcement of security rights after default by a grantor through “expeditious judicial and, subject to appropriate safeguards, non-judicial methods....”<sup>32</sup> As a general matter, it sets forth an overarching recommendation that covers any and all methods of enforcement by providing that in terms of enforcement all parties must conduct themselves “in good faith and in a commercially reasonable

<sup>12</sup> Recommendation 12.

<sup>13</sup> Recommendation 14.

<sup>14</sup> Recommendation 13.

<sup>15</sup> *Id.*

<sup>16</sup> Recommendation 32.

<sup>17</sup> Recommendation 35.

<sup>18</sup> Recommendation 54.

<sup>19</sup> Recommendation 57.

<sup>20</sup> *Bazinas, supra* at 11.

<sup>21</sup> Recommendation 76.

<sup>22</sup> Recommendations 99 and 100.

<sup>23</sup> Recommendation 76.

<sup>24</sup> Recommendation 77.

<sup>25</sup> Recommendation 92.

<sup>26</sup> Recommendation 93.

<sup>27</sup> Recommendation 31.

<sup>28</sup> Recommendation 81.

<sup>29</sup> Recommendation 85.

<sup>30</sup> Recommendation 86.

<sup>31</sup> Recommendation 93.

<sup>32</sup> Purpose Section (a) of Chapter VIII Recommendations.

manner.”<sup>33</sup> Furthermore, any party that fails to comply with the provisions on enforcement should be liable for damages caused by such failure.<sup>34</sup>

After a default has occurred, the Guide states that the secured creditor should have the following rights of enforcement:

1. Obtain possession of a tangible encumbered asset;
2. Sell or otherwise dispose of, lease or license an encumbered asset;
3. Propose that the secured creditor acquire an encumbered asset in total or partial satisfaction of the secured obligation;
4. Enforce its security right in an attachment;
5. Collect on or otherwise enforce a security right in an encumbered asset that is a receivable, negotiable instrument, right to payment of funds credited to a bank account or right to receive the proceeds under an independent undertaking;
6. Enforce rights under a negotiable document; and
7. Exercise any other right provided in the security agreement (except to the extent inconsistent with the provisions of the ultimate law enacted) or any law.<sup>35</sup>

It includes details for each enforcement remedy, as well as additional direction on matters such as advance notice of extrajudicial disposition of an encumbered asset,<sup>36</sup> distribution of proceeds after disposition<sup>37</sup> and passage of title upon disposition of an encumbered asset.<sup>38</sup>

## Acquisition Financing

The Guide generally follows a functional approach, meaning that it applies to all secured transactions regardless of how they are designated.<sup>39</sup> Therefore, acquisition financing (purchase money transactions) that includes retention of title by the creditor/lessor or transfer of title to the creditor are dealt with in the Guide.

The functional concept can be employed with respect to acquisition financing by use of two alternatives set forth in the Guide. The first alternative, akin to Article 9 of the UCC, is the “unitary approach” and provides that acquisition financing transactions are subject to all of the particular state’s rules

applicable to security rights.<sup>40</sup> The second alternative, the “non-unitary approach,” allows states to maintain different laws that are applicable to acquisition financing transactions so long as the financing portion of such transactions is subject to the secured transactions law.<sup>41</sup> Irrespective of the alternative utilized, the goal should be that ordinary secured transactions and acquisition finance transactions are treated equally.

## Insolvency

There is a chapter with recommendations on the interplay between a contemplated secured transaction law and a state’s insolvency law. Its specific recommendations in the insolvency chapter “supplement but are consistent with the recommendations in the UNCITRAL Legislative Guide on Insolvency Law.”<sup>42</sup>

## Conclusion

Overall, the Guide serves as a path to enact secured transactions law that can lead to significant economic benefits for states that choose to adopt the recommendations, “including attracting credit from domestic and foreign lenders and other credit providers, promoting the development and growth of domestic businesses (in particular small and medium sized enterprises) and generally increasing trade.”<sup>43</sup> Due to the current global credit market conditions, the Guide provides an important mechanism for states to utilize that are looking to achieve the results set forth in the previous sentence. States may even want to contemplate use of the Guide to enact a modern secured transactions law in order to facilitate secured financing in addition to other crisis-management devices that states may utilize in response to the global credit crisis. However, states must be mindful of the Guide’s caution that laws must be supported by efficient and effective judicial systems and other enforcement mechanisms in order to fully achieve their objectives.<sup>44</sup> ■

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<sup>33</sup> Recommendation 131.

<sup>34</sup> Recommendation 136.

<sup>35</sup> Recommendation 141.

<sup>36</sup> Recommendations 149-51.

<sup>37</sup> Recommendations 152-55.

<sup>38</sup> Recommendation 160.

<sup>39</sup> Recommendation 8.

<sup>40</sup> Recommendation 9.

<sup>41</sup> *Id.*

<sup>42</sup> Summary of the UNCITRAL Legislative Guide on Secured Transactions Law is available on the American College of Commercial Finance Lawyers Web site at [www.accfl.com/system/datas/10/original/LegislativeGuidesummary.pdf](http://www.accfl.com/system/datas/10/original/LegislativeGuidesummary.pdf).

<sup>43</sup> Guide Introduction A.2.

<sup>44</sup> *Id.*