

5. Report of the Secretary-General: security interests in goods (A/CN.9/102)*

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INTRODUCTION

1. At its third session the Commission requested the Secretary-General to make a study of the rules of security interests in goods under the principal legal systems and to make the information available to the Commission.¹ In pursuance of the Commission's request the Secretariat asked Professor Ulrich Drobnig of the Max Planck Institute for Foreign and Private International Law in Hamburg, to prepare a "Study on security interests" which has been published as document ST/LEG/11.

2. This report is in two parts. Part I summarizes Professor Drobnig's study. Part II contains the conclusions of the Secretariat in respect of the possible unification or harmonization of the law of security interests in the context of international trade and contains suggestions for future work on this subject.

I. SUMMARY OF THE STUDY ON SECURITY INTERESTS

A. *Scope of study*

3. The study on security interests, contained in document ST/LEG/11, deals almost exclusively with non-possessory security interests. This limitation is justified by the fact that under present-day conditions such a security is by far the most important, especially in international trade relations.² The primary source of information was legislative materials. However, where practicable, this material was checked for its practical application.³

B. *Contractual non-possessory security interests*

4. The study found a wide range of provisions in respect of contractual non-possessory security interests. The most liberal approach, adopted by some countries, facilitates the use of all goods for purposes of security. Under the least permissive approach the principle is maintained that security interests should be possessory in nature. Nevertheless, the need for credit to finance

the purchase of particular kinds of goods has led to the creation of special régimes of non-possessory security interests. In general these special régimes are restrictive in respect of the kinds of goods which can be used for security, the kinds of transactions, the persons who can be secured, and the extent to which the security agreement between the parties can cover advances to be made in the future or can subject to the security interest goods to be acquired in the future. They also tend to require more formalities for the creation of the security interest and for its enforcement than is true in countries which have adopted the more liberal approach.

5. The explanation for this dichotomy in approach appears to be "that in general a country's security rules tend to be more liberal, the more recently its legislation in this area has been enacted, and vice versa. This observation would indicate that the admission of a large number of, or potentially all, items as suitable objects of security is to a considerable degree a matter of technical modernization of this branch of the law."⁴

6. The study suggests that there are two main reasons which render non-possessory security interests suspect in some countries. "One is the novelty of the phenomenon and a consequent lack of legal experience in handling it. This, of course, is only a provisional stage of development which today has passed in general, but the traces of which are still lingering on."⁵ The study goes on to state that, "our present knowledge, especially the comparison with, and evaluation of, practical experience gained in many countries, enables legislation to be drafted which can satisfactorily solve all substantive and technical problems posed by non-possessory security interests".⁶

7. The second reason that non-possessory security interests are suspect in certain countries, is "the desire to protect unsecured creditors against secured creditors".⁷ This, the study concludes, is a valid concern but one which should be treated by means other than restrictions on the creation of security interests in goods.⁸

* 18 March 1975.

¹ Report of the United Nations Commission on International Trade Law on the work of its third session (1970), *Official Records of the General Assembly, Supplement No. 17 (A/8017)*, (UNCITRAL Yearbook, vol. I: 1968-1970, part two, III, A).

² International payments, study on security interests: note by the Secretariat, ST/LEG/11 (English only), p. 1.

³ *Ibid.*, p. 2.

⁴ *Ibid.*, p. 29.

⁵ *Ibid.*, p. 34.

⁶ *Ibid.*, p. 35.

⁷ *Ibid.*, p. 34.

⁸ *Ibid.*, pp. 35-36.

C. *Statutory non-possessory security interests in favour of unpaid sellers*

8. The study found that in addition to contractual non-possessory security interests many countries have enacted statutory non-possessory security interests in favour of unpaid sellers. Since such a security interest arises as of right, no contractual agreement or other formality is, as a rule, required for the creation of the interests.

"Wherever the legislator has created a protection of this nature in favour of sellers, the assumption obviously is that the voluntary extension of trade credit by sellers is a frequent and desirable phenomenon and that the credit-extending seller deserves special protection. This protection is particularly important in those countries which are, or at least were, reluctant to make contractual security interests available to sellers, such as France and many other Latin countries. The existence of a seller's statutory protection appears to be less called for in countries where sellers can easily create contractual security interests, especially by reservation of ownership."⁹

9. The study concludes that there are no special reasons which justify a general preference for unpaid sellers as against other creditors, as is granted by a statutory non-possessory security interest.

"This brings us to a necessary consequence of any abolition of a statutory interest in favour of the seller. Access to the contractual security interests must be facilitated, especially by doing away with any limitations as to the permissible parties and items of security and by eliminating burdensome formal requirements. The credit-extending seller must be enabled to provide easily for his own protection."¹⁰

D. *Current use of non-possessory security interests in international trade*

10. The study concludes that at the present time the conscious use of non-possessory security interests in international trade is not very frequent. A major reason is that the exporter "is confronted with a vast variety of widely differing national rules on security interests which may have little or no similarity to rules with which he is familiar."¹¹ On the other hand, the use of credit in international trade is substantial and constantly increasing.

11. As a result other institutions have been developed to provide security to the seller or to obviate its necessity. Among these the three most important are:

(a) Sales against documents, including the use of the letter of credit. This method secures the payment of the price to the seller. It does not provide the buyer with credit unless an additional agreement has been made with a bank or other financing institution;

(b) Guarantees, especially by banks, to secure payment of the buyer's indebtedness;

(c) The guaranteeing or insuring of the buyer's obligation to pay by a specialized institution in the seller's country. Such guarantees are usually provided within the framework of general export promotion.

⁹ *Ibid.*, p. 123.

¹⁰ *Ibid.*, p. 142.

¹¹ *Ibid.*, p. 189.

12. All three methods leave open the question of the security to the financing institution for the credit or payment guarantee it has made available. It would seem that these financing institutions, whether located in the buyer's country or in the seller's country, have turned increasingly to security interests in goods as the means of protecting themselves. In the second group which appears to use security interests frequently in international trade at the present time are exporters of plant and machinery where the size and duration of their trade credits often make the trouble and the costs of the necessary arrangements worth while.¹²

E. *Future use of non-possessory security interests in international trade*

13. The study concludes that:

"Since both the volume, and credit-demand in international trade are undoubtedly likely to increase, the need for security interests as a protective device will grow . . .

"The emphasis, as in the past, will be on security interests securing the purchase-price, either in favour directly of the seller or of a credit institution financing the seller (or buyer).

"Less certain is whether in the foreseeable future national credit institutions will grant more credit outside their territorial border to debtors in other countries, with a consequent increase in the use of security interests in goods located abroad. One can merely say that such a development is possible. It would also imply that the status of foreign-created security interests, which generally secure loan-credit, may, in future, assume relevance.

". . .

"In the result, it can be said with confidence that the factual importance of security interests in international trade is likely to increase within the next 10 to 20 years."¹³

F. *Conclusions*

14. From this, the study concludes, it follows that the harmonization or unification of the law of security interests as it affects international trade would be useful.

Three major methods to harmonize or unify the law are discussed: a uniform law convention, a model law, and recommendations. The study concludes that the preferable method in respect of security interests is to frame the rules in the form of a model law or model rules. It also suggests that the advice and assistance of the international financial institutions should be sought, both for the elaboration and for the propagation of such rules.¹⁴

II. CONCLUSIONS AND FUTURE WORK

15. The Commission may wish to consider whether the preparatory work carried out at its direction is now sufficiently advanced to enable it to decide on the continuation of its work in respect of the harmonization or unification of the law of security interests.

¹² *Ibid.*, p. 190.

¹³ *Ibid.*, pp. 190-191.

¹⁴ *Ibid.*, p. 222.

16. The study on security interests shows that there are several grounds that would justify a conclusion that work in respect of security interests should continue. The study indicates the following:

(a) Sellers and financing institutions alike are bewildered by the difficulty of knowing

- (i) Whether there is a security interest they might use effectively in a foreign country in which they wish to extend trade credit;
- (ii) What rights they would have under such a security interest;
- (iii) How the security interest should be created so that it would be valid against third parties; and
- (iv) How it should be enforced.

(b) The differences in legal rules make it difficult for security interests created in one country to be recognized in other countries. Therefore, the buyer's country may not recognize a security interest if the agreement was made in seller's country or if the buyer first took possession of the encumbered goods in seller's country.

(c) Some countries have no law of security interests which is adequate to protect the seller or other creditor.

(d) The lack of unified rules on security interests probably reduces the amount of trade credit available to buyers. This is perhaps of particular importance to the developing countries.

17. At the same time there is reason to expect that an important need in international commerce would be filled if a security interest, that would be enforceable by the foreign creditor against the debtor and third parties in the country where the goods are situated, were made available, through uniform rules, to merchants and trade and financing institutions.

18. As to the feasibility of preparing uniform rules, although the subject is complex, particularly because of the interconnexion between such rules and the national laws on bankruptcy, the Commission may wish to consider this question at a later stage in the light of a

further study that would bring into focus the following issues:

(a) Should the uniform rules take as point of departure the existing national legislations on security interests in goods and merely define the circumstances under which a security interest, created before the goods encumbered thereby are brought into the country of the forum, would be recognized? Or

(b) Should the uniform rules establish a new international type of security interest and, if so, what aspects of the law on security interests would be susceptible to such international unification? In this connexion:

- (i) As to scope, should such rules be tied to the international sale of goods (in other words, should they create a "purchase money security interest")?
- (ii) What should be the scope of the rights of buyer and seller and the rights of third parties dealing with them?
- (iii) With regard to what sales and to what types of goods should the uniform rules apply?
- (iv) What formalities should be complied with by the seller, or other person financing the purchase price, and within what period of time following the arrival of the goods in the country of destination, in order for the security interest to be enforceable against the buyer and third parties?

19. It is suggested that these and other issues could be isolated, for consideration by the Commission, if the feasibility study on the possible scope and content of uniform rules on security interests in goods were to take the form of a preliminary draft of such uniform rules accompanied by a commentary in depth. If the Commission desires that the Secretary-General undertake such work, it may wish to request the Secretariat to place the study before it at its tenth session and to consult, for purposes of preparing the study, with interested international organizations and trade and financing institutions.

6. List of relevant documents not reproduced in the present volume

<i>Title and description</i>	<i>Document reference</i>
<i>Working Group on International Negotiable Instruments, third session</i>	
Draft uniform law on international bills of exchange and international promissory notes: revised text of articles 5 (9), 6 and 12-41 ...	A/CN.9/WG.IV/CRP.3
Views expressed by banking institutions on certain questions relating to the draft uniform law on international bills of exchange and international promissory notes: note by the Secretariat	A/CN.9/WG.IV/CRP.6
Draft uniform law on international bills of exchange and international promissory notes: revised text of article 7	A/CN.9/WG.IV/CRP.7
Provisional agenda	A/CN.9/WG.IV/WP.4