Report to ACCFL members

From: Harry C. Sigman

Re: Uncitral Third International Colloquium on Secured Transactions (Vienna, 1-3 March 2010)

The United Nations Commission on International Trade Law completed its Legislative Guide on Secured Transactions (the "Guide") in 2007 and is nearing completion of a Supplement to the Guide relating to intellectual property as collateral. [Several ACCFL members were involved in creating the Guide and this Supplement.] At its annual meeting this coming June, the Commission will be considering what future work it might undertake. By way of preparation, Uncitral convened a Colloquium to discuss five potential projects. The purpose of the Colloquium was to gather experts and produce a discussion, reported by the Secretariat, that might inform the deliberations of the Commission.

The five potential projects covered were:

(1) A supplement to the Guide relating to security rights in securities not covered by the UNIDROIT Convention on Substantive Rules for Intermediated Securities;

(2) A model law on secured transactions, incorporating the recommendations of the Guide (including the IP Supplement).

(3) A guide relating to intellectual property licensing agreements;

(4) A project relating to registries for security rights, supplementing the material on that subject provided in the Guide; and

(5) A contractual guide relating to secured financing agreements.

The Colloquium began with two preliminary panels that presented a summary of highlights of the Guide and a picture of implementation of Uncitral texts to date.

In the second of these introductory panels, the following points were noted:

IFC Advisory Services (World Bank), which was deeply involved in the development in China of a legal structure to support receivable financing, claimed that during the course of the past year since implementation there had been a great economic impact in China, measured by the value of receivables financing registered in the new registry.

Law reform efforts must be geared to local conditions and are greatly impacted by local attitudes (e.g., in the Ohada countries there had been powerful opposition to the development of a centralized registry despite its obvious efficiency).

In connection with the recent development of a new Personal Property Security Act in Australia, which is largely based, at least conceptually, on the Guide: (i) the personnel involved had consisted of over forty IT people and four business managers and only ten lawyers; (ii) it was asserted that the substantially different feel of that Act from the one adopted in New Zealand several years ago was

attributable to the differences in their economies; (iii) that the process of development of the law appeared to be more like that of the United States in that drafts were submitted to the public and public comment was invited; nevertheless, the process was very much top (government)-down in terms of the decisional process.

In connection with the ratification of the UN Convention on the Assignment of Receivables in International Trade, there was discussion of efforts toward that end underway in Canada and the United States. Several ACCFL members have been involved in these efforts. It was noted that the Canadian federalism structure is such that the provinces must table appropriate substantive legislation before Canada can ratify a convention relating to private law matters. A key substantive point is the issue of the location of the assignor (the conflicts pointer under the Convention). The definition of that pointer in the common law provinces is the chief executive office, not the province of organization, while the Quebec definition is closer to the UCC's place of organization. With respect to the United States, it was noted that here too there would be federalism issues; that there was ongoing cooperation between the Uniform Law Commissioners and the federal government concerning the ratification and implementation process; that a significant educational program would be called for; and that, notwithstanding the general lack of difficulty in light of the similarity of most substantive rules of the Convention to those of Article 9 and the presence of a substantially uniform Article 9, the United States would likely have to make a declaration to deal with the fact pattern of a Delaware corporation with its place of central administration in London.

A leading Dutch insolvency practitioner asserted that he sees better prospects for change in less developed countries than in the developed countries.

First future work panel (directly held securities):

This topic is being considered because collateral in the form of securities is excluded from the scope of the Guide.

This panel began with a description of the Unidroit intermediated securities project, adopted as the Geneva Convention. Although a final text was concluded in 2009, the accompanying Official Commentary is still in the process of development. Some key features of the Convention are: There is no requirement of internationality of securities. It becomes part of national law, and many of its rules refer to local non-Convention law. The sphere of application of the Convention is based on the definition of "intermediated securities" [capable of being credited to a securities account maintained by a securities intermediary (anyone other than issuer) and can be acquired or disposed of per the Convention]. The term "security" is defined for purposes of the Convention, in relation to a securities account. The Convention envisions an expanded concept of 'control'—by the making an entry on the account, and also allowing national law to permit other ways, e.g., filing. It does not adopt the UCC directly/indirectly held dichotomy. Certificated securities are excluded.

Unidroit is producing an accession kit, and quite possibly might undertake some more implementation work (which might even require further diplomatic-level work), in addition to a final official commentary. Unidroit might do a legislative guide for emerging markets on what it takes to run a well-functioning securities market (which might well include some corporate rules). Thus, the boundaries of the existing work and of possible future work are both far from precise, and there is both substantive and political concern about overlap, if not conflict, between the work of the two organizations (with many of the same member nations), and concern was expressed about coordination if the two organizations were to work simultaneously in the same area. It was noted that this matter of precise boundaries was

made more complex because different legal systems use the same or similar terms but with different meanings. Since the Unidroit work was not yet completed, it was felt that it was too early to conclude that there was no conflict or overlap. It was pointed out that the need for certainty was heightened by the use of securities as collateral by central banks to provide liquidity during the financial crisis. It is likely that these considerations will ultimately prove determinative (although it is not unlikely that reference will be made to the rules of the Guide should such work be undertaken by Unidroit).

In pointing out gaps left under the Geneva Convention, it was noted that the Convention does not deal with the creation of a security interest; that cash credited to a securities account is not included in the Convention; and that most other Convention rules are optional, subject to non-Convention law. It was also noted that the Convention differs from Article 9 with respect to the rule giving priority to the intermediary—although in the United States the Convention result can be achieved by a subordination agreement.

In arguing for this project to be included in Uncitral future work, it was noted that shares of the borrower itself or of its subsidiaries are a very important form of collateral and are routinely not held through intermediaries, although they might be "capable of" being so held. In the typical case of financing private companies, these are a vital part of the collateral package that induces lender to extend credit or offer better terms. It is not uncommon that the borrower is a holding company whose main or sole assets are shares of subsidiaries or that the borrowing business is comprised of a corporate group engaged functionally as a single business. The secured transactions remedies provided under the Guide enable expeditious and efficient default remedies, and in cases like these, those remedies enable an enforcement disposition in the form of a sale of the going concern as an entirety. It was also pointed out that the borrower may have vital non-transferable assets that cannot themselves be directly subjected to a security interest or assets that cannot be sold by themselves (e.g., naked sale doctrine concerning trademarks under U. S. law). Also, obtaining the shares as collateral might avoid legal impediments to the hypothecation by a subsidiary of its assets to secure a loan to the parent. It was noted by a banking expert that business patterns are changing, e.g., exporters are increasingly selling not to foreign importers but to their own subsidiaries in the foreign country (resulting in a growing need to finance subsidiaries, and that companies are becoming more sophisticated in ring-fencing assets through the use of subsidiaries rather than divisions.

It was recognized that some significant issues remained to be resolved if securities were to be brought within the scope of the Guide, such as the need to carefully distinguish them from negotiable instruments and certain types of receivables; what about joint venture interests? partnership interests? What about certificated or dematerialized that are held in a securities account; and what about directly held publicly traded securities? Conflict with custody and transfer rules of other law must be avoided. More broadly the concern was expressed that there must be avoidance of any conflict with the capital markets concerns of the Convention. On the other hand, it was noted that many appropriate rules are already found in the Guide—for certificated securities, the Guide's rules for tangibles and negotiable instruments might be used, and for dematerialized securities, the Guide's rules for bank accounts might be used.

Second future work panel (a model secured transactions law):

The discussion began with a review of the current state of affairs. It was suggested that there is no need in Latin America for an Uncitral Model Secured Transactions Law in light of the existing OAS Model Law. A similar lack of need in Europe was suggested based on the existence of the Model Law developed in the '90s by the European Bank for Reconstruction & Development and the recently issued

Book IX (on security over movables) of the European Draft Common Frame of Reference, which provides a sort of model or toolbox addressed to legislators. The DCFR is the successor project to a strongly-opposed proposal to develop a European Civil Code. Prepared primarily by academics, it is more an expression of preferences than a description of existing law in the countries of Europe, and it certainly does not purport to represent the expression of a jus commune. Book IX was in fact strongly influenced by the Guide, and, like the Guide, it is not a terse civilian codification but rather a lengthy and often detailed elaboration of rules; it consists of some 231 articles organized in 7 chapters. While it does not adopt conceptually the functional approach of UCC Article 9, dealing differently with title-based acquisition financing, it reaches the same results in significant part and adopts a notice filing methodology. Neither the EBRD Model Law nor Book IX could be considered a model law ready for enactment as such, even in Europe. Further, the view was expressed that many less-developed countries, particularly in Africa, needed more than the Guide and that a Model Law would be very useful for them in enacting a modern secured transactions law.

It was noted, however, that the question was not the virtues of a Model Law but whether Uncitral should prepare a model law. It was noted that there would be a significant risk of doing harm, i.e., that the process might well result in revisiting issues where sound results had been successfully achieved in the Guide, and that there was also the matter of opportunity costs of displacing other more worthwhile projects. Some questioned whether, as asserted by the project's proponents, the project could indeed be done quickly and could successfully be constrained to merely putting the Guide into statutory language. The marginal benefit was also questioned, since a country desiring to reform would nevertheless find in the Model Law only a starting point, as the reformed law would have to be fitted into the legal structure of the particular country and could not simply be adopted verbatim. It was questioned whether a country that lacks the expertise to implement the Guide would be able to effectively implement a Model Law. It was noted that recent reform efforts too often consisted of a small group of young people lacking both experience and expertise hurriedly working in a closed room to meet the requirements of a donor, and that many small countries have neither the intellectual nor the economic resources to use the Guide. It was also suggested that making law does not have to be done through legislation but might instead be made by caselaw over time. And, it was also pointed out that in many cases the Guide does, and a Model Law would, simply refer to "other law", rather than spelling everything out then and there, and that some rules might well be better placed in another statute. If Uncitral did undertake to develop a Model Law, would it actually change any existing rules, fill every gap extant under current law, attempt to cover every possible issue? Should an Uncitral Model Law use the same terminology and structure as the Guide? Reference was made to Ukraine and Quebec law reform experiences, and it was suggested that a Model Law might well be totally unresponsive to local facts on the ground.

While there clearly was great sympathy for the need for guidance beyond the Guide, there was not a clear sense that a Model Law was an obvious next choice for Uncitral's future work. Thus, while it might well survive on a list for future work, it did not seem likely to be undertaken immediately. The panel was divided, some of the panelists very strongly opposed to the project, another less strongly and some felt that the need outweighed the concerns, the latter noting that a model law for secured transactions has been on the agenda of Uncitral since the 1970s and that the Model Law would to help to move the Guide into actual legislation, especially in smaller countries and developing countries.

Third future work panel (an instrument on contractual aspects of IP licensing):

This panel began with a presentation calling attention to the great value of intellectual property in today's economies, the importance of licensing as a vehicle for exploitation of such property and the absence in many if not most countries of well-developed law with respect to licensing of intellectual

property. Indeed, it was recognized that there are not fixed universally-shared conceptual and terminological understandings of the various forms of intellectual property and the rights that they involve. Patent law was stated to be in need of streamlining and harmonization. It was asserted that the absence of clear law on many important issues was an impediment to the efficient deployment of such property. Further, lack of capacity in underdeveloped legal systems impedes the transfer of technology needed particularly in those societies. Having asserted the need for some legal guidance, some panelists seemed to seek primarily a facilitative framework that placed primary value on the freedom of parties to contract as they wish. It appeared that their goal was not to harmonize or even necessarily to modify current law but rather to enable parties by assuring the validity of their bargain.

Less clear was the desirable form of an instrument, to whom it should be addressed and which organization was best suited to undertake to develop it. It was noted that that WIPO, a sister United Nations organization, works exclusively in the intellectual property field and thus has some internal expertise with respect to the types of assets involved, and has over 1000 employees. A concept paper, based to some extent on the Unidroit Model Law of Leasing, was presented in support of the position that a model law of licensing would be feasible, although it appeared that some of the panelists were seeking an instrument aimed at governments in a soft-law form such as a legislative guide. Some of the issues that might be covered include validation of hell or high water clauses, overriding anti-assignment provisions in the context of sale of an entire business, limiting the remedy for breach by the licensee to damages and precluding cancellation, and validating liquidated damages clauses.

One speaker stressed that the instrument, in whatever form, should be developed jointly by government, university and business; should provide autonomy re profits; should recognize competition rules and some state control over licenses; should lessen formalities; and should pay careful attention to details and be highly specific. It was asserted that a guide is feasible and desirable to clarify and facilitate harmonization of the legal environment. Past efforts in this field should be studied. A portal of resources should be developed along the lines of that provided by WIPO for trademarks. This speaker ultimately favored a guide aimed at governments, developed by the three stakeholders. He asserted, however, that patents are somewhat unique (but recognized that often a patent holder has composite rights).

Another speaker focused specifically on trade secrets and trademarks. With respect to the former, legal problems noted included the absence of a fixed universal definition, how confidential they must be to qualify as protectable secrets, whether they constitute property in the relevant countries, the differing extent to which they are governed contractually, and the role of criminal sanctions. With respect to trademarks, the speaker focused on repute and stressed the need for a public record, concerns about the mechanisms for recording, and highlighted concerns about transfer pricing between related entities. Also noted was the frequency of composite licensing, i.e., licenses that encompass more than a single form of intellectual property, and it was suggested that the issue should be dealt with broadly under the rubric of information asset transfer.

Fourth future work panel (a secured transactions registry project)

This panel unanimously expressed the views that there is a need for Uncitral to undertake further work on this topic and that the need is urgent. The view was strongly expressed that the chapter in the Guide on registration is sound in its recommendations of debtor-based, comprehensive coverage (as to types of transactions and types of assets), notice filing and its elaboration of those concepts, but that it is somewhat cryptic, is not quite complete and lacks sufficient detail to be directly usable by those not already familiar with the concept and lacking expertise in the operational aspects of registries. Thus, the

panel agreed that substantial supplementation is desirable and the question was not whether but how, i.e., what form the product should take.

It was stressed that very substantial guidance is needed because the most familiar model is the land registry, and that due to the important differences in purpose and governing policies, the notice filing model recommended in the Guide for security over movables would not be sufficiently understood and, consequently, the efficiency, simplicity, low cost and speed to be derived from that model would be lost, or at least significantly reduced. It was also noted that the notice filing model, unlike most land registries, easily allows for exploitation of the newest technology, is better adapted to preserve privacy with respect to the business terms of the secured transaction and involves a major difference in the role of the registry personnel, which must not act as a gatekeeper but essentially as an efficient receptacle, allowing the registry to facilitate filing and searching without interference.

As to the form of the product, it was asserted that even a set of detailed regulations (such as those prepared recently by the Organization of American States for use with the Inter-American Model Law, similar in some respects but certainly not identical to the Guide), while a step forward, would not be sufficient.

The panel consensus was that, at the very least, an elaborate introductory text, explaining all the key concepts and how they can best be implemented, should be provided. This could result in international minimum standards for procedures and operational capabilities. The product should include, in addition, both an explanation and a model text for the legal rules relevant to the registration system (e.g., the effect of erroneous data in the registry) and its administrative structure and a set of model Regulations (including alternatives), and accompanying commentary explaining policy choices and consequences.

It was pointed out that due to the combination of the notice filing concept and today's technology (available at a fairly low capital cost, particularly since today most operators, governmental or private, would already have some hardware that might be utilized for the registry as well), even a very busy registry can be set up at relatively low capital cost and can be operated by a staff of only one or two persons, accompanied by occasional information technology support and some public information capabilities. Moreover, electronic filings and online searching minimizes the risk of errors by registry personnel, essentially reducing that to the possibility of computer glitches.

There was strong support for a set of model regulations as a major part of the ultimate product. It was recognized that countries, particularly those at early stages of development, might have somewhat differing needs and might make somewhat differing choices, so a single set of regulations—one size fits all—would not be sufficient; thus, alternative regulations should be provided to enable varying modes of implementation and varying policy choices. Only such an approach would lead to the level of guidance needed by countries that lack the capacity to develop appropriate registries by themselves. Further, in each country, regulations would have to take into account the existence of registries for specific types of collateral (e.g., patents). And, it was also noted that while the basic element of registration by debtor (as contrasted with by asset) is central to the contemplated registry for all countries, the particular identifier(s) to be used, and the types of assets that might be susceptible to serial-number registration, might well differ from one country to another.

It was noted that while the Regulations should implement the Guide's recommendations, the product of this project should not be presented simply a supplement to the Guide. Making it a supplement might limit its influence to only those countries that had made a primary decision to adopt the Guide's content as its substantive law, while the product of this project, if not viewed as merely a supplement to

the Guide, could be extremely useful to countries that were interested in improving their existing registries or converting to a registration system, even if their substantive law differed from the Guide.

Mention was made of concerns about fraudulent use of the registry and, on the other hand, the risk of corruption in the operation of the registry.

It was also recognized that the product must be accompanied by practical educational programs aimed at registry personnel, at bankers and other users of the system, as well as lawyers. Of course, the registry itself should be user-friendly and provide online step-by-step guidance.

Fifth future work panel (a contractual guide for secured financing agreements)

This panel took up several different threads, all having in common the notion that while the Guide might give sufficient guidance to the legislator for the development of a modern secured transactions law, it left other needs unmet, particularly in less legally-sophisticated countries. One such need is the education of lawyers, particularly small firms and sole practitioners (as contrasted with repeat players such as bank counsel), and education of judges as to the purposes, policies and rules of the new law, and education of the 'users' of the new law—bankers, borrowers, suppliers, etc. Even in law-making, many countries' governments need direct capacity-building (lessening a need to turn to expensive law firms for assistance). It was also noted that educational programs would be useful in developing support for law reform.

A need for special guidance is also generated by the advent of new types of transactions facilitated for the first time under the new law, e.g., revolving credit. Thus, a contractual guide might democratize access to the new law, generate a more level playing field, make clear what provisions are customary/legitimate/ best practices, clarify which provisions are mandatory and which may be varied by contract, and enhance the quality of negotiation and documentation of secured transactions. The question of the form of such a guide was not definitively addressed, though it was noted that a list of questions (accompanied by explanations of their significance) might be useful to assure that all likely issues are covered, as well as one or more model forms of security agreement. A user-friendly guide, with a format aimed at how to help clients achieve their goals and protect their interests, was a very different product from a statutory text or a legal commentary. Such a contractual guide might be particularly helpful in agricultural financing and in cross-border financing and might also facilitate microfinancing. Such a guide might also usefully supplement the Guide, which, for example, doesn't define default, and might provide a model for some additional remedies that a secured party might find desirable (the Guide being permissive and not exhaustive in its catalog of remedies) and might provide useful suggestions concerning the appropriate (practical as well as legal) description of collateral. It was noted that in some countries, the idea of using a non-notarized private agreement to create a proprietary security interest is new, so guidance in the use of such a device would be needed.

One of the panelists stressed the particular need in less-developed countries for such a guide and related education programs, noting that local lawyers in some less-developed countries were unwilling/unable to learn new law, at least not without great difficulty, that law schools don't update their courses, that there is no training of judges or even much public discussion about new laws, and that only a miniscule number of people were likely to be involved in the development of new laws.

Although not directly on point, a government official in the audience expressed concerns about corruption, particularly in countries where computerization of records is not very advanced.