UNITED NATIONS

GENERAL ASSEMBLY

UNITED NATIONS COMMISSION ON
INTERNATIONAL TRADE LAW
Tenth session
Vienna, 23 May 1977

SECURITY INTERESTS

Report of the Secretary-General

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INTRODUCTION

1. At its eighth session the Commission requested the Secretary-General "to continue the feasibility study on the possible scope and content of uniform rules on security interests in goods and, for this purpose, to consult with interested international trade organizations and trade and financing institutions". The Commission also requested the Secretary-General to submit a final report on its feasibility study at its tenth session. This report is submitted in compliance with that request.

GENERAL SURVEY

Existing law

2. The existence of some forms of security interests in goods is a well-nigh universal phenomenon found in countries with all forms of legal, economic and political systems. At a minimum a possessory security interest in goods (i.e. a "pledge") seems to be generally available for consumer transactions and for the financing of small-scale commerce and farming operations. Nevertheless, in many countries the law of security interests does not serve the needs of modern commerce and, in particular, the needs of international commerce.

3. There is a wide variety of differing national laws in respect of security interests in goods. Even within a given country there is often a variety of security interests, each of which has its own rules as to such matters as the method of formation; the need for, the extent of and the forms of publicity to be given; and the means by which the creditor can realize on the security in case the debtor does not perform his obligation. Certain forms of security interests may be used in some countries only for certain kinds of economic activities, such as financing the purchase of goods, while other forms of security interests may be available for only certain kinds of goods, such as automobiles or farm equipment.

4. Frequently, therefore, no appropriate security interest is available for certain kinds of economic activity or in respect of certain goods, even though the availability of a security interest would seem appropriate from an economic point of view.
point of view. On the other hand in some cases the multiplicity of available security interests makes it difficult to know which form of security interest is most appropriate for a given transaction and leads to the possibility that after the debtor has become insolvent a court may rule that the form of security interest which was chosen by the parties is not enforceable against a third party in good faith.

5. The difficulties are compounded when the creditor is from a foreign country or if the goods subject to the security interest are to move from one country to another. There is an added burden of ascertaining the law of the debtor's country, which is usually the place at which the goods are located at the time the creditor must rely upon the security interest for protection. Furthermore, if the goods are to move from one country to another, it may be difficult or impossible to create a security interest in the goods which will be enforceable in all countries in which the goods may subsequently be located.

6. The explanation for this great diversity of security interests seems to lie in the fact that until recently the law governing security interests in goods has not been thought of as a unified whole. Instead, as the needs of commerce required the development of new types of security interests, they have been created by use of legal concepts which originally served other purposes. Thus, various types of security interest have been developed along entirely different lines depending on the underlying legal concept, e.g. whether the creditor had title to or possession of the goods, although in actual fact they were designed to fulfil similar economic functions.

Proposals for reform

7. The resulting complexity and general inadequacy of the law on security interests has inspired movements to re-examine and reform the law along functional lines. This reform has focused on the role which security interests play in the development of a modern system of commercial credit.

8. It has concentrated on creating a single unified type of security device, i.e. "the security interest", and has abandoned the traditional piecemeal approach of multiple security devices that were treated differently for no other reason than the underlying legal doctrine. Instead, the main criterion for different treatment is the different use for which the security interest is intended. For instance, different treatment has been given in certain respects for a security interest created to secure the unpaid purchase price from that given for a security interest created to secure a loan.

9. Such a reform based on functional considerations, first undertaken in the United States of America, 3/ has been initiated in various forms by several

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Canadian provinces (Manitoba, Ontario) and has been proposed for adoption by official governmental study commissions in several other Canadian provinces (British Columbia, Saskatchewan) as well as in Australia (Victoria), in India and in the United Kingdom.

10. The question has been raised whether a law of security interests based on functional considerations was as adaptable to the legal structure of the civil law as it has been to that of the common law, which has been its source, or to the needs of developing countries as well as to those countries with a developed economy.

11. No definitive answer can be given to these questions until an attempt has been made to draft a particular text and to resolve the many questions which would arise in so doing. However, a governmental study commission in one developing country (India) has officially recommended the adoption of such a reform and a study of the law of security interests in nine countries of South-East Asia commissioned by the Law Association for Asia and the Western Pacific (LAWASIA) and the Asian Development Bank reached the same conclusion. 4/ Moreover, of the nine countries considered in this later study, (commissioned for the Asian Development Bank) the commercial law of five of them is based on the civil law. Furthermore, one civil law jurisdiction (Québec) is officially considering the adoption of such a reform and several civil law scholars have suggested that such a reform be undertaken. 5/

Meeting of experts

12. In the light of these considerations the Secretariat arranged with the International Chamber of Commerce the convening of a meeting of experts to consider whether there is a practical need for international action in respect of security interests and, if so, what form that action might take. This meeting, held under the co-sponsorship of the two Secretariats, took place at the headquarters of the International Chamber of Commerce on 14 and 15 December 1976. The meeting was attended by individual experts and by representatives of international organizations.

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4/ David E. Allan, Mary E. Hiscock and Derek Roebuck, Credit and Security, Law and Development Finance in Asia (St. Lucia, University of Queensland Press, 1974; New York, Crane, Russack and Company, 1974). The law of security interests in each of these nine countries has been treated in a separate volume.

13. After extensive discussions the meeting was of the consensus that the
eexisting disparities in national law in respect of security interests in goods
are a significant impediment to the development of international trade. It was
noted that the majority of the laws in respect of security interests in goods
were prepared from a strictly national point of view without taking into
consideration the needs of international trade.

14. It was concluded that three techniques were available to reduce the problems
on an international level:

(i) Preparation of rules of conflict of laws;

(ii) Creation of substantive rules which would apply only to international
transactions; and

(iii) Unification of the national law on security interests by means of a
uniform law applicable both to national and to international
transactions.

15. It was noted that the technique of preparing rules on conflict of laws does
not solve many of the more difficult problems and, in particular, that it would
not modernize the law so as to meet the needs of international commerce. It was
also noted that the European Economic Community had considered and rejected this
approach.

16. In regard to the advisability of preparing substantive rules in respect of
security interests which would apply only to international trade, it was thought
to be extremely difficult both technically and politically to prepare a text
which would make available to foreign creditors certain rights which might not
be available to domestic creditors.

17. It was concluded, therefore, that the preferable approach would be to prepare
a text of uniform law which would apply to domestic as well as international
transactions. It was noted that this approach had been followed in respect of
negotiable instruments by the adoption of the Geneva Conventions of 1930 on bills
of exchange and promissory notes and those of 1931 on cheques.

18. The meeting also concluded that the proposed new text should create a new
security interest based on a functional approach which would be more suitable
to the needs of commerce and which would assure that a security interest created
in one country would receive full recognition in another. In this respect there
was a detailed discussion of the policy considerations which the new security
interest should implement. The meeting was of the view that, although the
preparation of such a text would be a formidable undertaking, the eventual text
could be assimilated into the legal systems based on the civil law as well as
those based on the common law.
CONCLUSION

19. The Commission might wish to conclude that there is a practical need for uniform rules on security interests in goods and that for this reason it is justified to begin work towards the preparation of such rules. The Commission might also conclude that these rules should take what has been described above as a functional approach and that an attempt should be made to bring within their scope of application domestic as well as international transactions.

20. In the light of the foregoing the Commission may wish to request the Secretary-General to prepare a draft of such rules accompanied by a commentary and to present the draft and commentary to the Commission at its twelfth session. The Commission may also wish to request the Secretary-General to carry out the work in consultation with interested international organizations, including banking and trade organizations, and, where special circumstances so require, with the assistance of consultants, and for these purposes to convene meetings as required.