UNCITRAL’s Guide to Secured Transactions – a Contractual Guide

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UNCITRAL's Guide to Secured Transactions –
a Contractual Guide

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1. INTRODUCTION

A Contractual Guide to the UNCITRAL Secured Transactions Guide (hereinafter: the ‘Guide’) can serve several purposes for several audiences. Each of these purposes is important to the adoption of a secured transactions law as recommended by the Guide and the successful implementation of such a law. The adoption of a law based on the Guide itself does not guarantee the success of secured transactions reform.

The audiences for a Contractual Guide include:

- those that will adopt and implement a secured transactions law: the State’s legislature and the State’s ministries of commerce and the like
- potential users of a secured transactions law: secured lenders and borrowers (referred to as “grantors” in the Guide).

In contemplating these sets of users, a Contractual Guide should contemplate its use by large and small users: from banks and credit institutions to lawyers and entrepreneurs. It should be prepared with the understanding that eventually judges and juries might need to understand and implement the agreements entered into under the secured transactions law.

The Contractual Guide should be even-handed in providing sample terms for the benefit of both the secured creditor and the grantor. The purposes of a Contractual Guide include:

- assuring a State’s legislature that the adoption of a secured transactions law that follows the recommendations of the Guide will be

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effectively implemented

- giving confidence to users of a secured transactions law that they will be able to use the secured transactions law effectively and with confidence that their transactions will meet their commercial expectations.

A Contractual Guide should not be confused with a legislative guide, such as the Guide. A legislative guide is for the legislature. A Contractual Guide is primarily for the users of a secured transactions law. However, it will provide comfort to the legislature that a secured transactions law will in fact be effectively used by the business community. In addition, isolated legislative reform would not be enough. The reform process must be accompanied by an adequate regulation of registries, the design of an adequate registry, as well as substantial instruction for the users, judges and all the agents involved.

II. -- GENERAL PRINCIPLES

A Contractual Guide should recognize several principles:

A Contractual Guide should guide -- A Contractual Guide should strive to provide as much guidance as possible to persons using the Guide. It should try to avoid raising questions without also providing proposed answers to those questions. A Contractual Guide should suggest best practices for particular terms.

Plain language -- Because the kinds of transactions that will be covered by a law based on the Guide might be new and novel in some States, the forms of agreements might be daunting. To the extent possible, the Contractual Guide should be stated in simple and easy-to-understand language.

General relationship with contract law and the law of obligations -- A secured transactions law will not replace all of contract law and the law of obligations. A Contractual Guide should explain how the secured transactions law works with the law of contracts and the law of obligations and how those sets of laws work with each other in contracts that are used in transactions under a secured transactions law.

Party autonomy under the Guide -- A Contractual Guide should point out that the Guide provides for extensive party autonomy. Thus any suggested provisions for agreements under the Guide can often be modified to suit the business needs and agreement of the parties to the secured transactions. The

1 Secured Transactions Guide recommendation 10.
agreement of the parties determines many rights and obligations of the parties.  

The Contractual Guide should also point out that the Guide contains certain mandatory rules. These include the obligations of good faith and commercial reasonableness, which cannot be waived. Other provisions are not mandatory. In other circumstances, the Guide permits variations from the recommendations of the Guide following the default of the grantor. As a general matter, the agreement of the secured creditor and the grantor cannot affect the rights of a third party.

Relationship with consumer law – The Contractual Guide should remind its users that transactions involving consumer and small business grantors may be subject to restrictions based on laws of the State directed to persons in those groups. It would be useful to identify specific provisions of secured transactions documents that may be affected by such laws.

Civil and common law – A Contractual Guide will have to take into account differences in civil and common law jurisdictions and how those differences affect the drafting of agreements. This may affect, for example, the level of detail in agreements and the method of expressing the agreement.

Substance over form – Many legal systems give effect to the label that a contract puts on a transaction. The Contractual Guide should alert parties to a secured transaction that a transaction subject to a law that follows the Guide will be evaluated based on its economic substance. Thus the parties to the secured transaction should craft the contract with the expectation that the terms will be read and enforced as a secured transaction.

Status of legal reform – The Contractual Guide should take into account that some States may also be engaged in the reform of their legal and judicial systems in other respects, which will have an effect on the level of detail and expectations of the parties to a security agreement.

2 Secured Transactions Guide recommendation 110.
3 Secured Transactions Guide recommendation 111.
4 Secured Transactions Guide recommendation 132.
5 Secured Transactions Guide recommendation 112.
6 Secured Transactions Guide recommendations 133 and 134.
7 Secured Transactions Guide recommendation 135.
8 Secured Transactions Guide recommendation 8.
Negotiation guide or contract guide? – The preparation of a Contractual Guide should consider whether, in addition to including sample contract terms, the Contractual Guide should include negotiation pointers. These might include providing reasons for possible positions and negotiating positions on possible terms. In any event, the Guide should provide annotations about the pros and cons of taking various approaches to the terms of a security agreement.

Updating – As States and users of a secured transactions law become more familiar with operating under a law that follows the recommendations of the Guide, practices will change. There should be provisions for updating the Contractual Guide to reflect these practices.

III. – TYPES OF PROVISIONS THAT A CONTRACTUAL GUIDE SHOULD INCLUDE

Form of agreement – The Contractual Guide should provide for written agreements, oral agreements, and electronic agreements. There may well be different approaches to the terms of the security agreement depending on the method of forming the agreement.

Minimum content – The Contractual Guide should explain that a security agreement must contain certain minimum content and provide examples of how to express that information.

Intent to create a security right – The security agreement must express an intent of the parties to create a security right. The Contractual Guide should provide examples of how to state that intention.

Information about the grantor – The Contractual Guide should explain the importance of properly identifying the grantor. This has significance for confirming that the grantor is the person who owns the encumbered assets. It can also provide a basis for the proper identification of the grantor on a registration in the secured transactions registry.

The secured creditor will want the agreement to confirm information about the form of legal entity of the grantor, and the jurisdiction of its formation and the place where the central administration of the grantor is exercised, which is important to determine where to register a security right in

9 Secured Transactions Guide recommendations 11, 12 and 15.
intangible encumbered assets. In some jurisdictions, a grantor may have a unique number that can be used to identify the grantor in a registration. The security agreement should provide for the statement of that information.

Identification of the secured creditor – Although the Guide contemplates less detail about the secured creditor than it does about the grantor, the security agreement must still identify the secured creditor.

Description of encumbered assets – Existing law in States may not have the same requirement as the Guide does to include a reasonable identification of the encumbered assets. The Contractual Guide should provide examples of how to do this. Certain types of assets are not subject to the Guide. The Contractual Guide should make suggestions on how to deal with these types of encumbered assets in the context of a secured transaction that is subject to a law that follows the Guide. For tangible assets, there should be information on the location of the assets. This will be important for the secured creditor to know where to register a security right as to those assets.

Identification of the secured obligation – The security agreement must identify the obligation secured by the encumbered assets. In addition, if a State adopts an optional recommendation of the Guide, the security agreement must also state the maximum amount of the secured obligation.

Default – The ability of the secured creditor to enforce its security right is critical to the meeting of the commercial expectations of the secured creditor. This is also a benefit to the grantor because the ability of the secured creditor to meet its expectations should positively influence the cost of credit. The security agreement should have definitions of when a “default” occurs and the remedies that a secured creditor would have, in particular any remedies that are not specifically provided for as automatically available under the Guide.

Choice of law – The Guide recommends that the parties to a security agreement have some ability to choose the law applicable to some of the rights of grantor and secured creditor as between each other.

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13 Secured Transactions Guide recommendation 208.
17 Secured Transactions Guide recommendation 203.
19 Secured Transactions Guide recommendation 132.
20 Secured Transactions Guide recommendation 216.
Other matters – There are a variety of other matters that the Contractual Guide should cover with sample language for the consideration of the secured creditor and the grantor. These include:

- Is the grantor the same person as the borrower?
- Does the security agreement secure all the relevant obligations (e.g., variable/fixed amounts, interest, costs)?
- Is the security for the relevant obligations subject to any legal restrictions (e.g. because the obligation is uncertain)?
- Is there a clear payment schedule in the credit (or main) contract and a clear/efficient way of proving a default (including in case of covenants – i.e. debt/capital ratios, EBITDA)?
- Is there any mechanism to reduce/increase the secured amount? Which party controls the mechanism? Is it effective?
- Does the person providing the security have the right to do so? Are there any limitations that should be considered?
- Is there any restriction on using the assets as security? Are any third party rights or public regulations applicable?
- Does the security agreement describe the asset(s) in a comprehensive way? Does it include important related assets/parts (e.g. accessories, spare parts, manuals, records, rights of way, list of quantities, description of quality)?
- Are there any special rights or obligations that the parties should consider or include in the scope of the security (e.g., rights of way, right to access the site)?
- Does the secured creditor need any additional right or related asset/right to make the asset useful/resalable in case of enforcement of the security?
- Does the secured creditor need to consider any special provisions because the asset is generic?
- Are the asset’s characteristics or its legal position/rights likely to change? Does the secured creditor need to include any provision in this regard?
- Are the assets covered by insurance? Is the insurance sufficient (amount of the insurance, insured risks)? Does the secured creditor need to be jointly insured?
- Should the security agreement include any covenants to protect the
encumbered assets or mitigate the risk of loss/deterioration? Should it limit the right to change the location of the assets, define non-acceptable levels of deterioration/change or other important aspect (or consider these as events of default)?

- Should the security agreement limit the right to transfer title of the assets, use them to secure additional obligations or any other important aspect (or consider these as events of default)?
- Should the security agreement indicate how to provide notice to the debtor, including the notices required by the Guide? 21
- Should the security agreement include any special provisions to make effective extrajudicial enforcement (e.g., keeping an extra set of keys, having an express right to access the site, etc.)?
- Should the security agreement provide for arbitration in relation to any aspects of the contract?

A significant reason to have in mind at the time of preparing a Contractual Guide is that, in the last resort, the parties look for their agreements to be executable. It is true that the minimum indispensable requirements are contained in the Guide, but a Contractual Guide will be equivalent for purposes of preparing a security agreement and related documents. This way, the users will have a tool that will develop concrete aspects to consider in many types of basic security documents, and that can be used either because the legislation is not sufficient or because at the end its wording is ambiguous or incomplete.

IV. – CONCLUSION

A Contractual Guide will complement the possible adoption of a secured transactions law that implements the Guide. Although its main objective will be for users, a Contractual Guide can also be a useful tool to everyone involved in the process: from the legislature, government ministries, registry authorities, and judges.

A Contractual Guide will provide comfort to legislators and users in States that do not have modern secured transactions laws. It will help those persons have confidence that a State can successfully use a secured transactions law based on the Guide and is an integral part of a State’s consideration of adoption of a secured transactions law based on the Guide.

21 E.g., Secured Transactions Guide recommendation 151.