



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW  
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**UNIDROIT Working Group on a Model Law on  
Warehouse Receipts**

***Fourth session (hybrid)***

**Rome, 28 February - 2 March 2022**

UNIDROIT 2022

Study LXXXIII – W.G.4 – Doc. 5

English only

February 2022

**NOTE ON  
SECURITY RIGHTS IN WAREHOUSE RECEIPTS**

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## I. DISCUSSION PAPER - CONSENSUAL SECURITY RIGHTS

1. The past two decades have witnessed the progressive emergence of a consensus regarding the key tenets that should be at the heart of a modern secured transactional law. The UNCITRAL Model Law on Secured Transactions (MLST) and its supporting Practice Guide (PGST) represent the most recent and authoritative embodiment of this consensus.

2. With the aim of providing a structural blueprint and a substantive reference point for a prospective Model Law on Warehouse Receipts (Model Law), the discussion below introduces the key legal issues concerning the creation, perfection, priority and enforcement of security rights in warehouse receipts (WRs). For consistency and simplicity, the MLST is used as the point of reference.

### A. Creation

3. The MLST conceptualizes security rights as property rights in movable assets that are effective *erga omnes*. Nevertheless, this legislative instrument distinguishes between the moment when a security right becomes enforceable between grantor and secured creditor and that in which it becomes effective against third parties. In this schema, a security right is treated as having been created when grantor and secured creditor satisfy all requirements established for it to become enforceable *inter partes*.

#### General Principles

4. Under the MLST, A security right may encumber any type of moveable asset – including after-acquired – and secure one or more obligations of any type.

5. A security right is created by agreement between the grantor and the secured creditor, provided that the grantor has rights in the asset to be encumbered or the power to encumber it. For non-possessory security rights, such an agreement must be in writing – including electronic records – and signed, yet no terms of art or linguistic formulations are required. Security agreements must contain the information to identify the grantor and the secured creditor, as well as a generic or specific description of the encumbered asset and the secured obligation. Differently, for possessory security rights, the agreement can be oral provided that the secured creditor is in possession of the collateral.

6. A validly created security right extends into the identifiable proceeds of the encumbered assets. If the encumbered asset is commingled in a mass, the security right extends into that mass.

#### Asset-specific rules applicable to documents of title

7. For creation, the MLST contains an asset-specific provision that is cardinal to the effective use of documents of title as collateral. MLST Art 16 states that:

“A security right in a negotiable document extends to the tangible asset covered by the document, provided that the issuer of the document is in possession of the asset at the time the security right in the document is created.”

This provision receives the long-established principle that a document of title reifies rights in the assets it covers. It establishes that the creation of a security right in a document of title concurrently and automatically creates a security right in the goods covered by the encumbered document. Accordingly, a security right in goods deposited in a warehouse can be created simply by creating a security right in the relevant WR.

8. Notably, MLST Art 16 contains a material limitation to this principle. A security right in a negotiable document of title extends to the assets covered by that document, only if the issuer of the document is in possession of the assets when the security right is created. If this condition is satisfied at the time of creation, the security right in the tangible assets covered by the document continues to exist even after the assets are no longer in the possession of the issuer of the negotiable document.

Questions for the Working Group:

- *To what extent should the Model Law incorporate the general regime for the creation of security rights established by the UNML?*
- *Should the Model Law expressly establish that a security right in a negotiable document extends to the tangible asset covered by the document, provided that the issuer is in possession of the asset, directly or indirectly, at the time the security right in the document is created?*

## **II. PERFECTION**

9. The MLST generally requires an act other from and ulterior to creation for a security right to become effective against third parties. When this act is carried out the security right is said to have been “perfected”. Typically, the normative aim of perfection is to institute some form of public notice of the actual or potential existence of a security right in a determinate asset and, thus, eliminate secret liens.

General Principles

10. The MLST establishes two primary methods to perfect a security right. First, a secured creditor can file a notice in a specifically designated security rights registry, the function of which is to enable secured creditors and other claimants to give notice of their rights to third party searchers, including other secured creditors or claimants as well as prospective buyers. Second, a secured creditor can perfect a security right by taking possession of the of encumbered asset; notably, in such cases, perfection is lost in the event of relinquishment of possession.

11. Accordingly, under the MLST, a security right in a WR may be made effective against third parties either by registration in the general security rights registry or by transfer of possession of the document to the secured creditor during the period that the assets are covered by the document.

12. Although the MLST does not touch upon this issue, it should be noted that secured transactions laws of several jurisdictions provide that if a WR is issued in electronic format a security interest may be perfected by control.

Asset-specific rules applicable to documents of title

13. The MLST contains an asset-specific provision that addresses perfection of security rights in documents of title. Its focus is on the relationship between the third-party effectiveness of a security right in a document of title and the third-party effectiveness of a security right in the tangible assets covered by the document. MLST Art 26 states:

- “1. If a security right in a negotiable document is effective against third parties, the security right that extends to the tangible asset covered by the document ... is also effective against third parties.

2. During the period when a negotiable document covers a tangible asset, a security right in the asset may also be made effective against third parties by the secured creditor's possession of the document.

3. A security right in a negotiable document that was effective against third parties by the secured creditor's possession of the document remains effective against third parties for [a short period of time to be specified by the enacting State] after the document or the asset covered by the document has been returned to the grantor or other person for the purpose of dealing with the asset."

14. This provision contains three rules. First, consistently with MLST creation rules under which a security rights in a document of title extends into the assets covered by the document, MLST Art 26.1 establishes that perfection of a security right in a tangible document automatically perfects the extending security right in the assets covered by the document.

15. Second, leveraging the link between document of title and covered goods, MLST Art 26.2 establishes that, if a secured creditor has a security right in goods covered by a document of title, they may perfect their security right by filing a notice but also by taking possession of the document of title, for as long as the assets are covered by the document.

16. Third, the MLST acknowledges that a secured creditor may often have to relinquish possession of an encumbered document of title to enable the grantor to deal with the assets in the course of the grantor's business (i.e., take redelivery of the deposited goods from the warehouse and sell them). In principle, this loss of possession would result in the lapse of third-party effectiveness, unless the secured creditor had also achieved third-party effectiveness through registration. MLST Art 26.3 grants secured creditors a temporary period of automatic third-party effectiveness following relinquishment of possession of the document to enable the grantor to deal with the covered assets. Consequently, the security right remains effective against third-party rights that arise during the temporary period even if the security right is not otherwise made effective against third parties before the expiry of the period. This policy choice is consistent with the short-term nature of financing transactions based on assets covered by a negotiable document, including WRs.

Questions for the Working Group:

- *Should the Model Law establish a special perfection regime for WRs?*

*If yes:*

- *Should the Model Law provide that security rights in WRs can be perfected only by possession or also allow other method – such as filing – in so far as they are recognized by the secured transactions law of the relevant jurisdiction?*
- *What if the jurisdiction in question lacks a general security rights registry but has adopted a special registry for WRs?*
- *Should the Model Law expressly incorporate the three asset-specific perfection rules enshrined in MLST Art 26?*
- *If the Model Law includes special rules for EWRs, should control be recognized as a method for perfection?*

### III. PRIORITY

17. The MLST contains an elaborate set of provisions that resolve conflicts between rights of competing claimants in a grantor's assets by establishing an order of priority. These rules determine whether and the extent to which a specific secured creditor may obtain the economic benefit of its right in an encumbered asset in preference to any other competing claimant that derives its rights in that asset from the same grantor.

#### General Principles

18. The key tenet that lies at the heart of MLST priority framework is succinctly described by the phrase "first to file or, otherwise, to perfect". Competing security rights are ranked based on the time when they became effective against third parties, except for security rights perfected by registering a financing statement the priority of which is fixed at the time of filing. Analogously, if an encumbered asset is sold or otherwise transferred while the security right in that asset is effective against third parties, the buyer or other transferee acquires its rights subject to such security right.

19. The MLST complements this general priority tenet with several asset-specific rules which differ from it in that they are not temporal in nature. Notably, the claims of purchase money secured creditors and buyers in the ordinary course of business are governed by a priority regime that departs from the "first to file or, otherwise, to perfect" axiom. Similarly, the priority regime for competing claims to certain receivables and payment instruments focuses on facilitating their negotiability and circulation rather than temporal considerations.

#### Asset-specific rules applicable to documents of title

20. The MLST establishes a special priority regime to govern conflicts between rights of competing claimants in a grantor's document of title and the assets that it covers. MLST Art 49.1 states:

"... a security right in a tangible asset made effective against third parties by possession of the negotiable document covering that asset has priority over a competing security right made effective against third parties by any other method."

21. This rule governs priority among competing security rights in the same document of title. It grants priority to secured creditors that perfect their security right taking possession of the encumbered negotiable document over those who do so by filing. Eschewing temporal considerations, the normative aim of this priority rule is to encourage reliance on negotiable documents as a medium of commerce.

22. Although the MLST does not touch upon this issue, it should be noted that secured transactions laws of several jurisdictions provide that if a WR is issued in electronic format and a security interest perfected by control has priority over competing security interests perfected by filing. MLST Art 49.2 establishes an exception to the rule in MLST Art 49.1:

"Paragraph 1 does not apply to a security right in a tangible asset other than inventory if the security right of the secured creditor not in possession of the negotiable document was made effective against third parties before the earlier of:

- (a) The time that the asset became covered by the negotiable document; and
- (b) The time of conclusion of an agreement between the grantor and the secured creditor in possession of the negotiable document providing for the asset to be covered by a negotiable document so long as the asset became so covered within [a short period of time to be specified by the enacting State] from the date of the agreement."

23. This rule limits the reach of the non-temporal priority rule in MLST Art 49.1. It addresses a conflict between a secured creditor that has perfected a security right in certain assets and a competing claimant who later takes possession of a subsequently issued document of title which covers those same assets. To resolve such a conflict, MLST Art 49.2 departs from the rule in MLST Art 49.1 and returns to the general priority regime of the MLST based on temporal order. The ratio is to prevent documents of title and their priority regime from being used as tools that allow grantors to reset the priority ladder to certain assets unilaterally. Nevertheless, it should be noted that the rule in MLST Art 49.2 does not apply to inventory (defined as tangible assets held by the grantor for sale or lease in the ordinary course of the grantor's business), as the MLST takes the view that protecting the negotiability of documents of title covering this type of collateral is paramount.

24. MLST Art 49.3 completes the special priority regime for documents of title. It addresses conflicts between a transferee of a negotiable document of title that obtains possession and secured creditors that hold a security right in that same negotiable document and the tangible assets covered by it was that was not perfected through possession. In such cases priority is awarded to transferees who take possession of the document of title, provided that they have satisfied the due negotiation requirements established by the applicable law.

Questions for the Working Group:

- *Should the Model Law provide a special priority regime to govern conflicts between competing claimants who have rights in documents of title and/or the assets which they cover?*

*If yes:*

- *Should this priority regime replicate that found in Art 49 MLST?*
- *What should be the priority regime applicable to EWRs? Should control be given special consideration in line with possession for paper WRs?*

#### **IV. ENFORCEMENT**

25. The MLST provides an elaborate enforcement regime for security rights. On one hand, this body of rules enables secured creditors to exercise dominion over the encumbered assets and obtain satisfaction for their secured obligation. On the other, it erects protections for the debtor in default to safeguard their residual proprietary interest in the collateral. The challenge is to balance the diverging prerogatives of secured creditors and debtors.

General Principles

26. The MLST provides secured creditors with two enforcement avenues in the event of debtor default. They may repossess and sell the encumbered assets and distribute the sales proceeds pursuant to the applicable priority rules. Alternatively, they may propose to acquire the encumbered asset in total or partial discharge of their unsatisfied secured obligation.

27. The secured creditor can exercise these rights either through judicial proceeding or through out of court measures. Regarding extra-judicial enforcement, repossession of the collateral is conditional upon the security agreement expressly contemplating this option and the secured creditor notifying both the grantor and whomever might be in possession of the collateral. Notably, opposition to such notice halts the extra judicial process. Similarly, if the secured creditor seeks to either dispose of or acquire the collateral extra-judicially, they must notify the grantor and any other competing claimants of record. Regarding judicial enforcement, the MLST defers to the procedural rules of the relevant jurisdiction but requires that distributions of the proceeds comply with its priority regime.

Asset-specific rules applicable to documents of title

28. The MLST does not provide asset specific rules for the enforcement of security rights in documents of title. Accordingly, the regime generally applicable for all assets also covers WRs. Within this body of rules and principles MSLT Art. 78.8 deserves special consideration. Notably this provision established that notifications which the secured creditor must tender to the grantor prior of disposing of the collateral on default are not required if the collateral “perishable, may decline in value speedily or is of a kind sold on a recognized market”.

Questions for the Working Group:

- *Should the Model Law incorporate enforcement provisions for security rights in WRs which replicates the judicial and extra-judicial options provided by the MLST?*

*If yes:*

- *Which enforcement rights should be conferred to secured creditors?*
- *Should secured creditors be granted the right to enforce their security only by application to a court or other authority or also without such an application?*
- *Which rights should be granted to debtors in default?*
- *Which rights should be granted to warehouse operators?*

**PART II: DRAFTING SUGGESTIONS****CHAPTER XXX. SECURITY INTERESTS**

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.1 Warehouse receipts can be encumbered</b>	
1. Warehouse Receipts can be the object of a security interest.	
2. [Security interests in warehouse receipts are governed by [Name of relevant statute], subject to Articles XXX.2-XXX.9]	

Comments

This provision is not strictly necessary. Para. 1 establishes the general principle that WRs can be encumbered. This might be helpful in jurisdiction that do not expressly recognize WRs as personal property or have an uncertain history in respect of using documents of title as collateral.

Para. 2 establishes the principle that security interests in WRs are subject to the general secured transactions regime of the jurisdiction in question, except for the asset specific rules included in this Model Law.

**Part A. Creation**

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.2 A security right in a warehouse receipt extends to the goods which it covers</b>	
1. A security right in a [negotiable] warehouse receipt extends to the goods which it covers, provided that the issuer of the warehouse receipt is in possession of the goods at the time the security right in the warehouse receipt is created	

Comments

This article, consistently with MSLT Art 16, embodies the long-established principle that a document of title reifies rights in the assets it covers. It establishes that the creation of a security right in a WR concurrently and automatically creates a security right in the goods covered by the encumbered WR. Accordingly, a security right in goods deposited in a warehouse can be created simply by creating a security right in the relevant WR.



Notably, consistently with MSLT Art 16 this article contains a material limitation to this principle. A security right in a WR extends to the assets covered by it, only if the issuer of the WR is in possession of the assets when the security right is created. If this condition is satisfied at the time of creation, the security right in the tangible assets covered by the WR continues to exist even after the assets are no longer in the possession of the issuer of the negotiable document.

Issues for the working group

The working group may wish to consider whether the rule established in this article should only apply to “negotiable” WRs or to all WRs.

**Part B. Perfection**

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.3 Third party effectiveness of a security interest in warehouse receipts extends to the security right in the goods which it covers</b>	
1. If a security right in a [negotiable] warehouse receipt is effective against third parties, the security right that extends to the goods which it covers in accordance with article XXX.2 is also effective against third parties.	

Comments

This article, consistently with MSLT Art 26.1, embodies the long-established principle that perfection of a security right in a WR automatically perfects the extending security right in the assets covered by the document.

Issues for the working group

Should the Model Law provide that security rights in WRs can be only perfected pursuant to determinate methods of possession (e.g. only by possession or also allow other method, including filing?)

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.4 Temporary third party effectiveness</b>	
1. A security right in a [negotiable] warehouse receipt that became effective against third parties by the secured creditor’s possession of this warehouse receipt remains effective against third parties for [a	

short period of time to be specified by the enacting State] after the warehouse receipt or the goods covered by the document has been returned to the grantor or other person for the purpose of dealing with the goods.	
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Comments

A secured creditor may often have to relinquish possession of an encumbered WR to enable the grantor to deal with the assets in the course of the grantor's business (ie take redelivery of the deposited goods from the warehouse and sell them). In principle, this loss of possession can result in the lapse of third-party effectiveness, unless the secured creditor has also achieved third-party effectiveness through filing or another method of perfection.

This article, consistently with MSLT Art 25.3, would grant secured creditors a temporary period of automatic third-party effectiveness following relinquishment of possession of the warehouse receipt to enable the grantor to deal with the covered assets. Consequently, the security right would remain effective against competing claims that arise during the temporary period even if the security right is not otherwise made effective against third parties before the expiry of the period. This policy choice is consistent with the short-term nature of financing transactions based on assets covered by WRs.

### Part C. Priority

Suggested text	Discussion
<b>Article XXX.5 Priority of security interests in warehouse receipts</b>	
1. Subject to paragraph 2, a security right in goods made effective against third parties by possession of the [negotiable] warehouse receipt covering those goods has priority over a competing security right made effective against third parties by any other method.	
2. Paragraph 1 does not apply to a security right in goods other than inventory if the security right of the secured creditor not in possession of the [negotiable] warehouse receipt was made effective against third parties before the earlier of:	
(a) The time that the goods became covered by the warehouse receipt; and	
(b) The time of conclusion of an agreement between the grantor and the secured creditor in possession of the [negotiable] warehouse receipt providing for the goods to be covered by a [negotiable] warehouse receipt so long as the goods became so covered within [a short period of time to be specified by the enacting State] from the date of the agreement.	
3. A transferee of an encumbered negotiable warehouse receipt that obtains possession of it under [the relevant	

law to be specified by the enacting State under which certain transferees of negotiable documents acquire their rights free of competing claims] acquires its rights free of a security right in the negotiable document and the goods covered thereby that is made effective against third parties by any other method.	
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#### Comments

This article establishes a special priority regime for security rights in WRs and the goods which they cover.

Paragraph 1, consistently with MLST Art 49.1, affords priority to secured creditors that perfect their security right taking possession of the encumbered negotiable WR over those who do so by any other method. Eschewing temporal considerations, the normative aim of this priority rule is to encourage reliance on negotiable documents as a medium of commerce.

Paragraph 2 limits the reach of the special priority rule in Paragraph 1 in respect of priority conflicts between a secured creditor that has perfected a security right in certain goods and a competing claimant who takes possession of a subsequently issued WR which covers those same goods. Paragraph 2 resolves this conflict pursuant to the general principle of *prior in tempore potior in iure*, consistently with MLST Art 49.2. The aim is to prevent WRs and their special priority regime from being used as tools that allow grantors to reset the priority ladder to certain assets unilaterally. It should be noted that this rule does not apply to inventory (defined as tangible assets held by the grantor for sale or lease in the ordinary course of the grantor's business), embodying the policy view that protecting the negotiability of WRs covering this type of collateral is paramount.

Paragraph 3 addresses conflicts between a transferee of a negotiable WR that obtains possession and secured creditors that hold a security right in that same negotiable WR and the tangible assets covered by it that was not perfected through possession. In such cases, consistently with MLST Art 49.3, priority is awarded to transferees that take possession of the negotiable WR, provided that they have satisfied the due negotiation requirements established by the law of the relevant State.

### **Part D. Enforcement**

#### Comments

The MLST does not provide asset specific rules for the enforcement of security rights in documents of title. Accordingly, the regime generally applicable for all assets also covers WRs.

#### Issues for the Working Group

The Working Group should decide whether the Model Law should include special rules for the enforcement of security rights in WRs.

To facilitate the Working Group's discussion, a very basic set of enforcement provisions has been provided below. They articulate the following regime:

On default:

- A secured creditor with a security right in a WR would have a right – exercisable with or without application to court – to dispose of the encumbered WR and the goods which it covers
- Debtors would have a right to receive a notification informing them of the secured creditor's intention and to oppose such enforcement proceedings
- In the context of the enforcement of a security interest in a WR, a warehouse operator would have a right not to deliver goods until the encumber WR is either surrendered to it or to the court

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.6 Post-default rights</b>	
1. After default, the grantor and the secured creditor are entitled to exercise:	
(a) Any right under articles xxx.7-xxx.8; and	
(b) Any other right provided in [the security agreement or] any other law, except to the extent it is inconsistent with the provisions of this Law.	
2. Before default, the grantor or the debtor may not waive unilaterally or vary by agreement any of its rights under articles xxx.7-xxx.8	

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.7 Methods of exercising post default rights</b>	
1. The secured creditor may exercise its post-default rights by application to [a court or other authority to be specified by the enacting State] or without such an application.	
2. The exercise of the secured creditor's post-default rights without application to [a court or other authority to be specified by the enacting State] is determined by the provisions of this chapter.	

Suggested text	Discussion
<b>Article XXX.8 Right of secured creditor to dispose of an encumbered warehouse receipt and the goods it covers</b>	
1. After default, the secured creditor is entitled to sell, lease, license or otherwise dispose of an encumbered warehouse receipt and the goods it covers by applying or without applying to [a court or other authority to be specified by the enacting State].	
2. If the secured creditor decides to exercise the right provided in paragraph 1 by applying to [a court or other authority to be specified by the enacting State], the method, manner, time, place and other aspects of the sale or other disposition, lease or licence are determined by [the rules to be specified by the enacting State].	
3. If the secured creditor decides to exercise the right provided in paragraph 1 without applying to [a court or other authority to be specified by the enacting State], the secured creditor may select the method, manner, time, place and other aspects of the sale or other disposition, lease or licence, including whether to sell or otherwise dispose of, lease or license encumbered assets individually, in groups or altogether.	
4. If the secured creditor decides to exercise the right provided in paragraph 1 without applying to [a court or other authority to be specified by the enacting State], the secured creditor must give notice of its intention to: <ul style="list-style-type: none"> <li>(a) The grantor and the debtor;</li> <li>(b) Any person with a right in the encumbered asset that informs the secured creditor of that right in writing at least [a short period of time to be specified by the enacting State] before the notice is sent to the grantor;</li> <li>(c) Any other secured creditor that registered a notice with respect to a security right in the encumbered asset at least [a short period of time to be specified by the enacting State] before the notice is sent to the grantor; and</li> <li>(d) Any other secured creditor that was in possession of the encumbered asset when the enforcing secured creditor took possession.</li> </ul>	
5. The notice referred to in paragraph 4 must be given at least [a short period of time to be specified by the enacting State] before the sale or other disposition, lease or licence takes place and must contain: <ul style="list-style-type: none"> <li>(a) A description of the warehouse receipt and the goods it covers;</li> <li>(b) A statement of the amount required at the time the notice is given to satisfy the secured obligation, including interest and the reasonable cost of enforcement;</li> <li>(c) A statement of the date after which the encumbered asset will be sold or otherwise disposed of, leased or licensed, or, in the case of a public disposition, the time, place and manner of the intended disposition.</li> </ul>	
6. The notice referred to in paragraph 4 must be in a language that is reasonably expected to inform the recipient about its content.	

<b>Suggested text</b>	<b>Discussion</b>
7. The notice referred to in paragraph 4 need not be given if the encumbered asset is perishable, may decline in value speedily or is of a kind sold on a recognized market.	

<b>Suggested text</b>	<b>Discussion</b>
<b>Article XXX.9 Rights of warehouse operator</b>	
1. A warehouse operator may not be compelled to deliver goods for which it has issued a [negotiable] warehouse receipt due to the enforcement of a security right in such a warehouse receipt, until its possession or control has been surrendered to the warehouse operator or to the court.	