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UNCITRAL Legislative Guide on Secured Transactions and its Implications on the Korean Legal Regime

담보거래에 관한 UNCITRAL 입법지침의 국내 적용 가능성

Jae Sung Lee

한국법제연구원
KOREA LEGISLATION RESEARCH INSTITUTE

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연구자 : 이재성(UN법무실 선임연구원)

Jae Sung Lee

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한국법제연구원

KOREA LEGISLATION RESEARCH INSTITUTE

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Ⅰ. Introduction

It has been reported that, starting from 2009, scholarly efforts will be put into reforming the Civil Code of Korea, possibly resulting in a complete overhaul of its Civil Code which looks not so different from what it looked like 50 years ago.[1] In a similar context, the Special Registry Research Team of the Supreme Court Administrative Branch prepared a draft legislation on the registration of assignments of movable assets and receivables in late 2007.[2] These reform efforts share a simple goal of putting into clear and concise language, the principles of law developed by Korean courts in their application of the Civil Code during the past fifty years, especially those concerning secured transactions. The objective of this paper is the same, to provide some insights on the implications of the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Secured Transactions (hereinafter "the Guide"), particularly concerning the reform of Part II of the Civil Code, dealing mainly with real rights in property. In fact, it is hoped that this paper shall become a guide to the Guide which consists of 541 pages which includes 242 recommendations.

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1) See Naeil Shinmoon, "Dongsan chaekwon dambo jaegong sheoejind", 2008. 9. 8 availabl e at http://www.naeil.com/News/politics/ViewNews.asp?nnum=421774&sid=E&tid=

2) See Yoon, Seung Keun, "Hankookaeseoeui dongsan mit chaekwon dambobeub ibbeob donghyang bogo." See also Seoul Gyungjae, "Dongsandamboro don bilinda", 2007. 11. 29 available at http://economy.hankooki.com/lpage/economy/200711/e2007112918485670100.htm

Ⅰ. Introduction

A typical Korean, when asked which kind of asset could be used to secure an obligation or a contractual performance, would first think of the mortgage system and probably answer “real estate or immovable property.” In such circumstance, one may ask why real estate is the dominant type of encumbered asset for securing obligations in Korea. Answers may vary but this is probably because the value of real estate is higher compared to other types of assets and also because a registration system has already been set in place for grantors to publicize the existence of a security right on the property. But more significant is the fact that the legal regime governing real estate is more transparent compared to that governing other types of assets, providing assurance to secured creditors that they will be more likely to enforce their security rights in case of default of the debtor.

The fundamental problem arising from a secured transactions regime primarily based on real estate is that not everybody has access to such property and that it is costly. Small and mid-sized businesses in Korea are starving for affordable credit because they do not own any land or building(s) to provide as security to creditors. On the other hand, creditors are also reluctant to lend money to these businesses due to lack of confidence that they will be able to enforce their security rights in a default situation. Modern secured transaction legislations have an important influence on the availability and the cost of credit, as they address important issues such as the creation, third-party effectiveness, priority and enforcement of security interests. Access to and cost of

credit also has an impact on the price of goods and services, and also affects both national and international trade.

Demand for credit by businesses was often and is still frustrated by the lack of a suitable legal framework through which borrowers could grant security rights to lenders and other credit providers. The reasons may vary: ⅰ) granting of security over certain types of asset may be prohibited; ⅱ) no legal framework exists for such purposes or ⅲ) a legal device to serve the purposes of the parties involved might just be inefficient, costly and too complex to operate. These problems stimulated the development of various transfer-of-title mechanisms and the extensive growth and deviations of retention-of-title agreements intended primarily to increase their efficiency as a legal device for securing the performance of obligations.

The bottom line is that the current legal regime regulating secured transactions in Korea, especially for assets other than real estate, is out-of-date and does not provide the needed framework to support the financial transactions taking place in the real world. Some may argue that the over-development of financial techniques in providing credit was the cause of the recent sub-prime mortgage crisis in the United States, one of the reasons leading to the world financial crisis. They may argue that caution should be taken in introducing such framework. But this does not mean that the non-existence of such legal framework would have prevented the crisis. It is actually now that the small and middle businesses are in greater need of affordable credit, to survive through this

crisis. Without a framework to provide such credit, based on whatever property or value that they may have access to, it could mean that some of these innovative businesses may perish. The financial crisis that we face today exemplifies the need to set up a stable and transparent system for providing credit to businesses and for providing possible methods for secured creditors to enforce their security rights.

Ⅱ. Background History, Purpose and Structure of the Guide

1. Background History

The origin of the Guide may be traced way back in the history of UNCITRAL. A milestone in the journey of the project was a decision by UNCITRAL at its thirteenth session (1980) to postpone work in the area of security interests, after initial studies by the Secretariat showed that unification and harmonization of law in this field was unattainable due to the complexity of the subject matter and the divergences existing in domestic laws.

However, following recommendations made at the UNCITRAL Congress in 1992,[3] substantive work was commenced in the area of receivables financing. UNCITRAL concluded its work on receivables financing by adopting the United Nations Convention on the Assignment of Receivables in International Trade (the UN Assignment Convention).[4] The main objective of the Convention was to facilitate international receivables financing, for example, asset-based lending, securitization[5], factoring[6],

3) For the report of the Congress proceedings, see Uniform Commercial Law in the Twenty-first Century: Proceedings of the Congress of the United Nations Commission on International Trade Law, New York, 18-22 May 1992, United Nations publication, Sales No. E.94.V.14 (A/CN.9/SER.D/1).

4) Th United Nations Assignment Convention was adopted by the United Nations General Assembly and opened for signature in December 2001. See General Assembly resolution 56/81 of 12 December 2001. It will enter into force once ratified by at least five States according to article 45(1) of the Assignment Convention. As of November 2008, Luxemburg, Madagascar and the U.S.A. have signed the Convention and Liberia has acceded to the Convention.

forfeiting and project financing relating to receivables. With a view to meeting this objective, the UN Assignment Convention removes legal obstacles to receivables financing and enhances certainty with respect to certain key substantive issues and conflict-of-laws issues. The UN Assignment Convention covers all types of assignments including pure outright assignments, outright assignments for security purposes and assignments by way of security.

Contrary to the decision in 1970, UNCITRAL, in 2000, agreed that the development of modern secured transaction legislations could assist in the efforts of poverty reduction and address inequalities between parties in developed and developing countries, allowing each party to benefit from international trade.[7] Thus, in 2001, UNCITRAL established Working Group

5) Securitization is another highly effective form of financing involving the use of receivables. Securitization is a sophisticated form of financing under which a business enterprise can obtain less expensive financing based on the value of its receivables by transferring them to a wholly owned "special purpose vehicle" ("SPV") that will issue securities in the capital markets secured by the stream of income generated by such receivables. Securitization lowers the cost of financing because SPV is structured in a way to make the risk of its insolvency "remote" (e.g. theoretically not possible) by restricting the amount of debt that a SPV can incur. That significantly reduces one risk that the lender has to take into account when deciding what interest rate to charge for the loan. In addition, because the source of credit is the capital markets rather than the banking system, securitization can generate greater amounts of credit than bank loans and at lower costs than the normal bank loan costs

6) There are a number of different types of factoring arrangements. The factor may pay a portion of the purchase price for the receivables at the time of the purchase ("discount factoring"), only when the receivables are collected ("collection factoring"), or on the average maturity date of all of the factored receivables ("maturity factoring"). The assignment of the receivables can be with or without recourse to the assignor ("recourse" and "non-recourse" factoring) in the event of non-payment of the receivables by the debtors of the receivables (i.e. the customers of the assignor)

7) Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17 (A/55/17), para. 459.

VI on security interests and entrusted it with the task of developing an efficient legal regime for security rights.[8] The Working Group held twelve sessions during the period of 2002 to 2007 for the preparation of the Guide.[9] In view of the intersection between security interests and insolvency law, the Working Group also held two joint sessions with Working Group V on Insolvency[10] and coordinated its work with other international organizations such as International Institute for the Unification of Private Law (Unidroit), the Hague Conference on Private International Law, the World Bank and the World Intellectual Property Organization.[11] After six years of work, Working Group Ⅵ finally

8) Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 and corrigendum (A56/17 and Corr. 3), para 358.

9) The Working Group's report of the twelve sessions are available at http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.htm

10) For the report of first joint session (Vienna, 16-17 Dec. 2002), see document A/CN.9/535; and for the report of the second joint session (New York, 26 and 29 Mar. 2004), see document A/CN.9/550.

11) Official Records of the General Assembly, Sixtieth Session, Supplement No. 17 (A/60/17), para. 187. The Guide builds on the work of UNCITRAL and other organizations. Such works include the EBRD Model Law on Secured Transactions, completed in 1994; the EBRD "Core principles for a secured transactions law", completed in 1997; the Organization for Harmonization of Business Law in Africa Uniform Act Organizing Securities, prepared in 1997; the study on secured transactions law reform in Asia, prepared by the Asian Development Bank in 2000, the UN Assignment Convention adopted in 2001; the Convention on International Interests in Mobile Equipment, adopted in 2001 and the relevant protocols thereto; the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary, adopted by the Hague Conference on Private International Law in 2001; the Organization of American States (OAS) Model Inter-American Law on Secured Transactions, prepared in 2002; the UNCITRAL Insolvency Guide, completed in 2004; and the UNIDROIT preliminary draft convention on harmonized substantive rules regarding intermediated securities. The work also draws on article 9 of the Uniform Commercial Code as wells as the Personal Property Security Act of Canada and New Zealand.

provided the Commission with a complete set of recommendations and commentaries and it was considered during the fortieth and the resumed fortieth session of UNCITRAL (respectively, 25 June – 12 July and 10 – 14 December 2007, Vienna). In December 2008, the General Assembly adopted a resolution A/C.6/63/L.6 with regard to the Guide and recommended that all States give favourable consideration to the Guide when revising or adopting legislation relevant to secured transactions.[12)]

12) See General Assembly Resolution A/RES/63/121. See also the Report of the Sixth Committee to the General Assembly titled "Report of the United Nations Commission on International Trade Law on the work of its forty-first session", A/63/448.
The General Assembly
Recognizing the importance to all countries of efficient secured transactions regimes promoting access to secured credit,
Recognizing also that access to secured credit is likely to assist all countries and, in particular, developing countries and countries with economies in transition in their economic development and in fighting poverty,
Emphasizing the expectation that modern and harmonized secured transactions regimes which balance the interests of all stakeholders (including grantors of security rights, secured and unsecured creditors, retention-of-title sellers and financial lessors, privileged creditors and the insolvency representative in the grantor's insolvency) will demonstrably facilitate access to secured credit, thereby promoting the movement of goods and services across national borders,
Noting that the development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States,
Taking into account the need for reform in the field of secured transactions laws both at the national and international level demonstrated by the numerous current national law reform efforts and work of international organizations, such as the Hague Conference on Private International Law, the International Institute for the Unification of Private Law (Unidroit) and the Organization of American States, and of international financial institutions, such as the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Monetary Fund and the World Bank,
Expressing its appreciation to inter-governmental and international non-governmental organizations active in the field of secured transactions law reform for their participation in and support for the development of the draft UNCITRAL legislative guide on secured transactions,

2. Purpose

The purpose of the Guide is to assist States in the development and modernization of their domestic secured transactions laws to increase access to and to provide businesses with an alternative source of affordable credit. All businesses, at all levels, require working capital to operate, to grow and to compete successfully in the market. It is well established that one of the most effective means of providing working capital to businesses is through secured credit. Secured credit allows businesses to use the value inherent in their assets as a means of reducing the risk of their creditors. Creditors, by being able to access these assets in the event of non-payment of the secured obligation, are also at a lower risk. As the risk of non-payment is reduced, the availability of credit is likely to increase and consequently, the cost of credit is likely to fall. However, in States that do not have efficient and effective laws, where creditors perceive the legal risks associated with

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1. Expresses its appreciation to the United Nations Commission on International Trade Law for the completion and adoption of the Legislative Guide on Secured Transactions;
2. Requests the Secretary-General to disseminate broadly the text of the UNCITRAL Legislative Guide on Secured Transactions, transmitting it to Governments and other interested bodies, such as national and international financial institutions and chambers of commerce,
3. Recommends that all States give favourable consideration to the Guide when revising or adopting legislation relevant to secured transactions, and invites States that have used the Legislative Guide to advise the Commission accordingly; and
4. Recommends also that all States continue to consider becoming party to the United Nations Convention on the Assignment of Receivables in International Trade, the principles of which are also reflected in the Legislative Guide.

credit transactions to be high. As a result, the cost of credit normally increases, as creditors require increased compensation to evaluate and assume the increased risk.

In some States, the absence of an efficient and effective secured transactions regime or of an insolvency law regime under which security rights are recognized, has resulted in the virtual elimination of credit for small and medium-sized commercial enterprises, as well as for consumers.

In short, a legal system that supports secured credit transactions is essential in reducing the perceived risks of credit transactions and promoting the availability of secured credit. It is no wonder that secured credit is more readily available to businesses in States that have efficient and effective laws that provide for consistent and predictable outcomes for creditors in the event of non-performance by debtors. The significant economic benefits for States that adopt a sound secured transactions law is the increase in trade volume by attracting credit from domestic and, especially, foreign lenders and credit providers. The development and growth of businesses, particularly small and medium-sized companies are promoted and consumers also benefit because prices for goods may become lower and because credit to consumers is more readily available.

The Guide perceives that secured transactions laws should have the following key objectives in order to provide an effective and efficient framework for secured transactions:

○ To promote low-cost credit by enhancing the availability of secured credit;

○ To allow debtors to utilize the full value in their assets to support credit;

○ To enable parties to obtain security rights in a simple and efficient manner;

○ To provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions;

○ To validate non-possessory security rights in assets;

○ To enhance certainty and transparency by providing for registration of a notice in a general security rights registry;

○ To establish clear and predictable priority rules;

○ To facilitate efficient enforcement of creditor's rights;

○ To allow parties maximum flexibility in negotiating the terms of the security agreement;

○ To balance the interests of affected persons; and

○ To harmonize secured transactions laws, including conflict-of-laws rules.

The Guide also seeks to establish a balance among the interests of debtors, creditors (whether secured, privileged or unsecured), affected third persons, such as buyers and other transferees of encumbered assets, and the State.[13] Last but not least, the Guide seeks to overcome the differences among legal regimes to offer pragmatic and proven solutions

13) Certain debtors, such as consumer debtors, require additional protections. Thus, although the regime envisioned by the Guide will apply to many forms of consumer transactions, it is not intended to override consumer-protection laws or to discuss consumer-protection policies, since these matters are not appropriate for harmonization, furthermore unification

that can be accepted and implemented in States with divergent legal backgrounds.

Any reform effort in Korea to improve the secured transactions regime should take into full consideration the objectives mentioned above. In essence, the starting point of the debate concerning the reform should be whether the present regime, in its present form, is capable of achieving the above-mentioned objectives and how to improve it or if necessary to overhaul it, if the answer to the former question is in the negative.

3. The Structure of the Guide

A Legislative Guide The Guide takes the structure of a legislative guide because it was neither possible nor appropriate to draft an international instrument on secured transactions in the form of a convention or a model law. States were neither ready to agree on a single approach nor was there a consensus on the need to find a uniform solution and how to address them. Therefore, it was more appropriate to provide a legislative guide with a set of principles or legislative recommendations.[14] As a legislative guide does not necessarily have to provide a single set of model solutions, the Guide provides for alternatives, depending upon applicable policy considerations (i.e. see chapter on acquisition financing in the Guide). By discussing the advantages and disadvantages of different

14) The first legislative guide adopted by UNCITRAL was the Legislative Guide on Insolvency Law in 2004 recognizing the complexity of the issues and the need for a flexible approach, UNCITRAL also decided that the outcome of the work on security interest should also be in the form of a legislative guide.

policy choices in the commentaries, the Guide assists the readers in evaluating different approaches and allows them to choose from the options the most suitable one in their particular domestic context. For example, the fundamental difference between the two option, unitary and non-unitary approach provided in Chapter Ⅸ of the Guide relates to the treatment of retention of-title and financial lease right as a security right

Much flexibility is provided to Korean legislators who may wish to adopt the recommendation provided in the Guide. Thus, it is evident that the Guide could be used as a reference document for reform activities in Korea. It is also true that some elements of the Guide would not necessarily need to be reflected in the reform. Choices will need to be made. In the instances of the example mentioned above, discussions on the two options provided in the Guide with regard to retention-of-title and financial lease rights would be a staring point of discussions in Korea.

The regime envisaged in the Guide is purely a “domestic” one. The Guide is addressed to national legislators considering reform of “domestic” secured transactions laws. However, because secured transactions often involve parties and assets located in different jurisdictions, the Guide also seeks to address the recognition of security rights and title-based security devices effectively created in other jurisdictions. This would improve the situation for holders of those rights under the laws currently in effect in other States, as such rights often are lost once an encumbered asset is transported across national borders. It would also

encourage creditors to extend credit in cross-border transactions, a result that could vividly enhance international trade. However, this also has negative implications for States which may not be in a situation or are reluctant to reform its secured transactions regime. This is because their businesses will be less likely to obtain credit from foreign creditors and lenders as they would difficulties in gaining access to potential debtors in other States. The same shall apply to Korean businesses and banks seeking credit from foreign creditors and seeking foreign customers.

Organization The Guide consists of twelve chapters. In each chapter, there is a commentary, which includes an analysis of the key issues and the ways in which they could be addressed in domestic secured transactions legislations, followed by a set of legislative recommendations, addressed to legislators. At present, the pre-edited version of the Guide (hereinafter "Pre-edited version"), subject to the final editing by UN editors, is available at the UNCITRAL website and this paper is based on that version of the Guide.[15)]

Chapters on creation ⅱ), third-party effectiveness ⅲ), priority (V), rights and obligations of the parties to a security agreement (VI) as well as enforcement of security rights (Ⅷ) have a set of recommendations that apply generally to all types of assets (general recommendations) and a set of recommendations that apply specifically to certain types of assets (asset-specific recommendations) such as receivables, rights to payment of funds credited to a bank account, proceeds under independent undertakings,

15) The pre-edited version of the Guide is available at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.htm

money, negotiable documents and negotiable instruments, tangible assets covered by the negotiable documents, attachments and products or masses of goods. On the other hand, the chapter on the rights and obligations of third-party obligors only contains asset-specific recommendations. This is because, while some States may need to introduce legislations based on the general recommendations, a modern law on secured transactions would not be complete if it did not cover these specific assets, which reflect the major portion of corporate wealth.

It would be advisable if reforms efforts in Korea would be based on the general recommendations taking into account the asset-specific recommendations. But as can be seen from the experience of states like Japan and Canada, it could be possible to develop asset-specific legislations first to promote financing in a certain type of asset. The problem with such an approach, as experienced in those States, is that different regimes may be developed for each respective asset which could be, in the end, time and cost-consuming in its operation and also in the process of harmonization. For example, registries might be developed separately making it difficult to eventually harmonize them into a general registry.

Terminology Section E of the Introduction to the Guide is titled "Terminology and Interpretation" and is an essential component of the Guide. This section sets out principles behind the interpretation of terms used within the Guide[16] because the law of secured transactions lies at

16) Pre-edited version pg. 14.

the crossroads of several branches of national law and because the concepts may be used differently in various jurisdictions. In order to ensure clarity and to minimize misunderstanding, the Guide adopts precise terminology to express the concepts that underlie an effective secured transactions regime.[17] The terms used are not drawn from any particular legal system.[18] In order to facilitate precise communication independent of any particular national legal system, the Guide offers definitions of key terms used. These definitions are meant to enable readers of the Guide to understand its recommendations in a uniform way, providing them with a common vocabulary and conceptual framework.

It is somewhat difficult to match some of the terminology in the Guide to concepts that already exist in Korean law, whether be it secured transactions law or other law. “Proceeds” could be a good example as its scope is broader and somewhat different from similar concepts in Korean law such as “Gwashil” or “Mulsangdaewi”, which it is likely to be translated into.

To the extent the terms and concepts are not already a part of the Korean law, they would need to be fully defined if they are introduced. Ideally, Korea could simply incorporate these terms and concepts into a new law, changing nomenclature where necessary but maintaining the substance of the concepts. An alternative would be to take the meanings

17) Pre-edited version pg. 31.

18) Even when a term appears to be the same as that found in a particular national law, the Guide does not intend to adopt the meaning of the term in that particular national law.

as defined in the Guide as the basis for elaborating definitions in an enacting statute. In both cases, this could help avoid unintended substantive changes, maximize uniform interpretation of the new legislation and promote the harmonization of its secured transactions law with that of other States.

Ⅲ. The Current Secured Transactions Regime in Korea

Before looking into the Guide, this paper will assess the relevant provisions and practices in Korea regarding secured transactions on movable assets. The traditional methods provided in the Korean Civil Code for secured transactions are lien and pledge. In addition to these methods, non-traditional methods such as security rights by way of transfer or by way of provisional registration have also developed. Recently, secured transaction practices involving movable assets and bulk assignment of receivables have seen an increase, as can be witnessed in the recent judgments by the Supreme Court regarding such transactions.[19)]

Lien The lien is a form of possessory security, the right to retain physical possession of tangible assets as security for the underlying obligations. It is usually granted over an asset to secure the payment of a debt or performance of some other obligation. The Korean Civil Code provides for a passive right to retain property against its owner as security for obligations.[20)] The secured creditor (the lienee) merely has the right to refuse return of the assets and does not have the right to dispose of the assets.

Pledge The pledge is also a form of possessory security right, where the asset being pledged is physically delivered to the secured creidtor (the pledgee). Although pledges are rarely used in recent commercial

19) Kim, Jae-Hyung, “Discsussion on the UNCITRAL's Draft Legislative Guide on Secured Transactions”, Bigyosabeob Vol.13.4, pg. 42.

20) Korean Civil Code articles 320 to 328.

activities, pawnbrokers still remain and play a part of the credit industry. A pledge is a useful and efficient security device where the encumbered assets are already held by, or can easily be brought into the possession of a third party, typically a person engaged in the business of maintaining possession of assets owned by other persons. It also has proven useful when the encumbered asset can easily be held by the secured creditor or its agent, such as a negotiable instrument or a negotiable document.

As a security right, the traditional pledge has some advantages for the secured creditor because ⅰ) the grantor is unable to dispose of the pledged asset without the secured creditor's consent, ⅱ) there is almost no risk of devaluation of the pledged assets, ⅲ) the secured creditor may make use of the pledged assets if he/she wishes to, and ⅳ) the secured creditor is saved the trouble, time, expense and risk of having to obtain delivery of the encumbered assets from the grantor if enforcement is necessary.[21] The pledge also has advantages for third parties, because creditors without possession of the asset could avoid the risk of getting a false impression of the grantor's wealth which could have been possible, had the assets been in the grantor's possession.

Nonetheless, as we can see from the limited use of pledges in our commercial world, a pledge, as a security right, has major disadvantages, both for the grantor and the secured creditor. It is sometimes argued that the pledge is economically impractical in the business contexts. The greatest disadvantage for the grantor is that the grantor is precluded from

21) In such circumstances, the consent of the grantor is required and the secured creditor must take proper care of the assets.

utilizing the encumbered assets in its business, especially in situations where possession of the asset is necessary for it to generate income. Another important disadvantage is that the grantor cannot pledge assets that do not yet exist or in which the grantor does not have rights at the time of the pledge. This means that a number of important financing practices, such as inventory financing based on revolving credit facility, cannot be accommodated by the traditional pledge. For the secured creditor, the pledge has its disadvantage because he/she has to store, preserve and maintain the encumbered asset. If he/she is either unable or reluctant to perform these tasks, a third party would need to be involved, resulting in additional costs more likely to be borne by the grantor.

Like many other jurisdictions, it can be generally said that the Korean legal system is generally hostile to non-possessory security rights mainly because they lack publicity. However, debtors and creditors had to find other techniques to fill the gaps and to address obstacles in the granting of such non-possessory security rights. Consequently, non-traditional devices and techniques using titles were also developed in Korea to function as security rights or the equivalent of a security right and to supplement the existing regime. These instruments were developed through commercial practices and their validity was subsequently confirmed by courts. In other legislations, similar techniques have been either established or refined by legislation. The most common technique for creating the equivalent of a non-possessory security right in movables assets involves the use of title or ownership of the asset that is being

deployed for security purposes. The two typical situations where title is used for security purposes is as follows: ⅰ) to guarantee a loan, the grantor conditionally transfers title in his/her asset to the creditor; and ⅱ) to secure an unpaid purchase price, a seller or lessor simply retains title to the asset that is sold or leased until full payment of the purchase price has been made by the grantor. Both transfer-of-title and retention-of-title enable the creditor to benefit from rights that are equivalent to non-possessory security rights.

Transfer of title Transferring the title of the asset to the secured creditor either conditionally until the loan is repaid (*Yangdodambo*) or subject to a re-transfer to the borrower under a second sale by which the creditor retains title until the loan is repaid (*Maedodambo*) is often used for security purposes. Such technique is attractive for creditors in Korea because the requirements for transferring title in tangible or intangible property are often less difficult and less costly than the creating a security right. To be more precise, the current legal regime does not provide a framework to grant such non-possessory security rights. It is also practical, in the case of default of the grantor, as the secured creditor or the transferee enjoys the position as the owner rather than as a holder of a security right.

Today, approaches taken by States regarding transfer of title devices intended to serve such security purposes vary. In some States, their creation is subject to the less demanding rules and has the effect of a full transfer of title. In other States, their creation is subject to more

cumbersome rules governing security rights and they only have the effect of a secured transaction. In yet other States, especially in the civil law jurisdictions, many if not all such transfers of title are regarded as a circumvention of the ordinary regime of security instruments and are, therefore, held to be null and void. In States that have adopted a comprehensive and integrated regime for non-possessory security rights, transfer-of-title devices for security purposes are simply treated as security devices.

In Korea, there has also been the same discussion as to whether transfer of title for security purposes should be regarded as a security right. The general understanding and the case law of Korea seems to state that such devices should be regarded as a transfer similar to a trust. Between the grantor and the secured creditor, the grantor has ownership, may utilize the asset and may acquire any proceeds. However, with regard to third parties, the secured creditor obtains the title. Thus, complex problems including priority issues may arise when the grantor transfers the title to a third person for security purposes.

In the reform process, legislators will be faced with two policy options: ⅰ) to recognize security transfers of title with the greater effects of a full transfer, avoiding the general regime for security rights or ⅱ) to recognize security transfers of title, but to limit either the requirements or the effects or both to those of a mere security right. The former would enhance the secured creditor's position, while weakening the position of the grantor and the grantor's other creditors. The latter could be

implemented in several different ways. As can be seen in some civil law States, transfer of title transactions that will be permitted could be specified, prohibiting all others. Or, like many common law States, these security transfer of title transactions could be simply characterized as security rights. The Guide takes the latter approach as it generally recommends a integrated, comprehensive secured transactions regime.

Retention of title Another method of using title as security is through a contractual retention of title arrangement. Sellers reserve their ownership or the title of the tangible assets they are selling, as a means to secure payment of the buyer. In a simple retention of title arrangement, the seller retains title of the sold asset until full payment is made but there are variations: ⅰ) the seller merely promises to sell the property and title is transferred to the buyer only upon full payment; ⅱ) the sale is made conditional upon the purchaser paying the full price; and ⅲ) the sale is immediate and it is only the transfer of title that is made conditional upon the buyer paying the price. In any case, a common feature is that, even though the buyer may have possession and may make use of the property, rights in the property is not actually obtained until the purchase price is fully paid. Till then, title continues to vest in the seller.

Economically, a retention of title arrangement provides a security right that is particularly well adapted to the needs of sellers in securing credit. In many States, this kind of credit, which is typically made available by suppliers, is widely used as an alternative to general bank financing and

is given preferential status in view of its importance in the economy of small- and medium-sized suppliers of tangible assets. In other States, banks also provide acquisition financing on a more regular basis and, as a result, have developed practices that enable them to take advantage of the retention of title mechanism.[22)]

In those States, this source of credit as a specific security is often accorded a special privilege in the form of a higher priority over conflicting security rights in the same tangible assets, provided that certain formal requirements are met.

Many States regard retention of title arrangements as a mere quasi-security. As a result, they do not subject retention of title devices to general rules concerning security rights. In such circumstances, a retention of title arrangement can be agreed in a cost effective manner, as it would not be subject to publicity. At the same time, such arrangement could present certain disadvantages due to the absence of publicity. The positions of the buyer and the buyer's creditors are weakened and third parties have to rely on the buyer's representations or need to collect information from other sources. It also may prevent, or at least impede, the buyer from using the purchased assets for granting a second ranking security to other creditors, making it impossible to fully utilize the full value of the asset. Another disadvantage is that enforcement by the buyer's unsecured creditors is impossible or difficult

22) For example, a seller can sell tangible assets to a bank for cash and the bank then can resell the assets to the buyer on credit under a retention-of-title arrangement or a buyer might pay the seller in cash from a loan and then transfer title to the bank as security for the loan.

without the seller's consent. For these reasons, in some States retention of title arrangements are treated in the same way as security rights. Some treat them as security rights in every aspect, other in some but not all aspects. In yet other States, retention of title arrangements are ineffective as against third parties in general or if they relate to certain assets, especially inventory, on the premise that the seller's retention of title is incompatible with the seller granting to the buyer the right and power to dispose of the inventory in the ordinary course of its business.

The Korean case law also seems to view retention of title as a quasi security right in the sense that the transfer of title is made conditional upon the purchaser paying the full price. It was noted that even when the asset had been physically transferred to the buyer, he/she cannot assert the ownership to the seller nor to any third party until he/she has paid the full price. However, once he/she pays the full price, it is understood that the title is automatically transferred to the buyer without any legal action as the condition has been met.

In pursuing the reform of secured transactions regime, policy decisions on the treatment of retention of title would be necessary. One option would be to preserve the special character of retention of title as a title device fully or to limit its effects to securing only the purchase price of the affected asset and to restrict it to the purchased asset. Another option, which would be a dramatic change to the Korean legal regime, is to integrate retention of title arrangements into the ordinary system of security rights.[23)]

23) In such a case, the creation, third-party effectiveness, priority and enforcement, even in the buyer's insolvency, of a retention-of-title arrangement would be subject to the

Ⅳ. Implications of the Guide

1. Scope of the Guide

As mentioned above, the Guide recommends that States adopt a single, functional, integrated and comprehensive regime for secured transaction, which shall apply to all contractually created rights in movables assets that secure the payment or other performance of an obligation.

In recommendation 2, the Guide recommends that the law should apply to all rights in movable assets created by agreement that secure payment or other performance of an obligations, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or the secured creditor, or the nature of the secured obligation.[24] Indeed, this is a very broad scope covering almost all transactions regarding movable assets for security purposes. It may be worthwhile to note that, in many States today, not all legal devices that are meant to encourage lenders, sellers and other parties to extend credit are based on an agreement. Some devices arise by operation of law.[25] However, the Guide focuses on security devices based on agreements and not on statutory security rights. [26] The Guide also notes that any exception in the law should be limited and in such case, set out in a clear and

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same rules applicable to security rights. Under such an approach, for the policy reasons mentioned above, it would be possible to grant the seller certain advantage.

24) Recommendation 2 of the Guide.

25) Pre-edited version pg. 52. para. 49.

26) Ibid.

specific way in the law.[27)]

Faced with the inefficiency and gaps created by the approach of adjusting their traditional legal regimes to meet the credit needs of businesses, some States decided to rethink the whole field of security rights in movable assets from the middle of the 20th century.

The result of such discussion was the creation of a single, integrated, comprehensive and functionally defined concept of a security right in all types of movable asset. This approach was inspired by the reflection that the many different types of non-possessory security right, the traditional possessory pledge and the several variations on title-transfer and retention-of-title devices were all based upon a few identical guiding principles that aimed at achieving the same economic outcomes. The main theme in this approach is that substance must prevail over form.

It is no accident that this idea first developed in federal States, such as the United States of America and Canada, where for many years trade across state and provincial boundaries was hampered by the existence of diverse and highly particularized regimes for granting security. Article 9 of the Uniform Commercial Code of the United States, a model law now adopted by all 50 states, created a single, comprehensive security right in movable assets unifying numerous and diverse possessory and non-possessory rights in tangible and intangible assets, including transfer-of-title and retention-of-title arrangements, that existed under state statutes and common law.[28)] The

27) Recommendation 7 of the Guide.

28) For detailed provisions of Article 9 of the UCC, see http://www.law.cornell.edu/ucc/9

idea spread to Canada (including the civil law province of Quebec) taking the form of Personal Property Security Act.[29] New Zealand, India, Norway and other civil law states in Central and Eastern Europe have also followed the approach. The OAS Inter-American Model Law on Secured Transactions[30] and the EBRD Model Law on Secured Transactions[31] follows a similar approach in that it creates a specific security interest which can work side by side with other security devices (such as leasing) and re-characterizes retention of title as a security right.

Whether to adopt such a comprehensive approach or to approach each asset respectively is a fundamental question that needs to be answered in the discussion of the reform of the Korean legal regime as it could result in the overhaul of the present regime in the broadest sense. The experience of Japan and Canada, where regulations on different assets were developed respectively according to their needs, in the end, resulted in great confusion among the different regimes that govern each type of assets. Taking this into consideration, it might be better to adopt a single uniform approach for the reform rather than a stage-by-stage approach, which could seem more easy and reasonable at this stage.

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29) For detailed provisions of the Personal Property Security Act, see http://www.qp.gov.bc.ca/statreg/Stat/P/96359_01.htm.

30) For detailed provisions of the OAS Inter-American Model Law on Secured Transaction see http://www.oas.org/dil/cidipvisecuredtransactions_eng.htm.

31) Full text of the European Bank's Model Law on Secured Transactions and a commentary which explains concepts developed in the Model and the way they may work in practice is available at http://www.ebrd.com/pubs/legal/secured.htm .

Assets The Guide recommends, that in principle, all types of movable assets, tangible[32] or intangible[33], present or future[34], including inventory, equipment and other tangible assets, contractual and non-contractual receivables[35], contractual non-monetary claims, negotiable instruments and documents, rights to payment of funds credited to a bank account, rights to receive the proceeds under an independent undertaking[36], and intellectual property[37] should serve as collateral or encumbered assets

32) By definition in the Guide, tangible asset mean every form of corporeal movable asset. Among the categories of tangible asset are inventory, equipment, consumer goods, attachments, negotiable instruments, negotiable documents and money

33) By definition in the Guide, intangible asset mean all forms of movable assets other than tangible assets and include incorporeal rights, receivables and rights to the performance of obligations other than receivable.

34) The Guide stresses the need to enable a grantor to create security rights not only in its existing assets but also in its "future" or "after-acquired" assets (i.e. assets acquired by the grantor or created after the conclusion of the security agreement), without requiring the grantor or secured creditor to sign any additional documents or to take any additional action at the time such assets are acquired or created. This approach is consistent, for example, with the United Nations Assignment Convention, which provides for the creation of security rights in future receivables without requiring any additional steps to be taken. In addition, the Guide recommends recognition of a security right in all existing and future assets of a grantor through a single security agreement, a concept that already exists in some legal systems as an "enterprise mortgage", as a combination of fixed and floating charges, or as an "all-asset security right."

35) By definition the Guide, receivables do not include negotiable instruments, negotiable documents and bank accounts.

36) Independent undertaking refers to letter of credit and independent guarantees as used in the UN Convention on Independent Guarantees and Stand-by Letters of Credit.

37) The law recommended would, in principle, apply to security rights in intellectual property to the extent that the law is not inconsistent with the domestic and international intellectual property regime. See Recommendation 4(b). With few exceptions, the recommendations of the Guide are suitable to intellectual property financing transactions. It would be very difficult to exclude security rights in intellectual property rights since important financing transactions involving tangibles (e.g. inventory financing with a security right in all the assets of a company) would typically involve intellectual property rights, such as a patent or a trademark. However,

under the law.[38] It may be worthwhile to mention that UNCITRAL considered the future work in the field of security interests during the first part of the fortieth session and decided to entrust Working Group VI with the preparation of a document that would become an annex to the Legislative Guide, dealing specifically with security rights in intellectual property. In May 2008, discussions to develop such an annex started during the thirteenth session of the Working Group in New York.[39]

On the contrary, the Guide recommends that the law should not apply to security rights in aircraft, railway rolling stock, space objects, ships and any attachments thereto to the extent that it is inconsistent with the other law governing security rights in such assets.[40] It also recommends that the law should not apply to security rights in securities as they raise different issues and are usually subject to special legislations.[41] The Guide also recommends the exclusion of immovable property, as it also touches upon different issues and is subject to a special title registration system indexed by asset and not by the grantor.[42]

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to avoid undue interference with intellectual property laws, the Guide gives precedence to intellectual property law.

38) Recommendation 2(a) of the Guide.

39) More information about the recent sessions of Working Group VI (13th session, 19-23 May 2008, New York & 14th session, 20-24 October 2008, Vienna) on the treatment of intellectual property in secured transactions is available at http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html

40) Recommendation 4(a) of the Guide.

41) Recommendation 4(c) of the Guide.

42) Recommendation 5 of the Guide. There is an exception regarding attachments to immovable property, which can be subject to security rights covered by the Guide. However, immovable property may be affected by the Guide's recommendation. If a security right in mortgage secures a receivable, negotiable instrument or other intangible asset, and the receivable, negotiable instrument or other intangible asset is

The exceptions to the scope of application provided in the Guide are quite similar to the developments in Korea. Respective regimes have been developed for immovable property as well as to regulate security rights in automobiles, aircrafts, ships, construction machinery and factory estate, the common feature of these assets being that they are of high value. But, apart from the type of assets mentioned, here has been almost minimal transactions based on other types of assets mainly covered by the Guide in Korea and that is why it might be meaningful to consider the Guide in the reform of the general secured transactions regime.

Persons The Guide recommends that a secured transactions law should allow all legal and natural persons, including consumers,[43] to be able to create or acquire security rights. A yet different approach is taken in the proposed draft legislation by the Special Registry Research Team of the Supreme Court Administrative Branch as it limits the position of grantors to legal persons.[44] The rationale behind limiting the scope of persons seems to be that it is usually legal entities that need access to credit and that the registry of legal persons, which has already been computerized, may be used to register transactions, providing a transparent way of achieving third-party effectiveness and an objective source of information

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assigned, the security right in the mortgage follows. This rule deals with the effectiveness of a security right as between the secured creditor and the grantor and does not affect any third-party rights, priority and enforcement requirements existing under immovable property law.

43) Recommendation 2 (b). However, the Guide recommends that, in cases of conflict between secured transaction legislation and consumer protection law, the latter should prevail.

44) Yoon, Seung Keun, supra note 2.

for third parties. However, the contrary argument could be made that it is the small businesses and merchants that are in need of credit and that their importance in the whole economy should not be disregarded by preventing them from accessing credit.[45] The Special Registry Research Team seemed to have decided to limits its proposal to legal entities as they are the main grantors of security right by bulk assignment of receivables. However, it would be recommended that the scope of persons being able to use the secured transaction regime be not limited to a certain group or type of legal entities.

Secured Obligation All types of obligation, present or future, determined or determinable, including fluctuating obligations and obligations described in a generic way should be able to be secured. As seen from the example above, an alternative to this approach would be to limit the scope to certain obligations. However, this would entail developing respective regimes for each type of obligations and therefore, it would be highly recommended that all types of obligations be included in the scope.

Other transactions To ensure a comprehensive coverage of all devices that serve security functions, the Guide recommends that the law should apply to rights that serve security purposes but are not denominated as such (i.e., all property rights created contractually to secure the payment or other performance of an obligation, including transfer-of-title in tangible assets, assignment of receivables, various forms of retention-of title sales and financial leases).[46]

45) Ibid.

46) Recommendation 2(d) of the Guide. Moreover, the Guide recommends that the law

2. Creation of a Security Right and effectiveness between parties

The Guide states that the purpose of provisions on the creation of a security right is to specify the requirements that must be satisfied in order for a security right to be effective between the parties. The approach taken by the Guide in this respect is quite simple.

It recommends that a security right in an asset should be created "by agreement" between the grantor and the secured creditor.[47] Such approach coincides more with the common law system of the United States, Canada and New Zealand and is quite different from the Korean legal system, a civil law based system. In a civil law system, an additional element (i.e. transfer of possession, notification or registration) is usually required for the creation of a security right and the Korean legal system is no exception.[48]

This is because the fundamental element of a real right in a civil law system is that it should be effective against third-parties once it is created and that there is no longer an issue of priority once it is created. For example, pledge, which is the traditional way of providing security rights in movable assets in the Korean Civil Code, requires that the grantor obtains possession of the encumbered asset. Possession is, in fact,

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should apply also to outright transfer of receivables despite the fact that such transfers do not serve security functions. See Recommendation 3 of the Guide. This is to avoid characterization issues and to ensure that the registry system and the priority rules apply to all assignments of receivables.

47) Recommendation 13 of the Guide.

48) See Korean Civil Code article 188.

a very notable way of publicly announcing that the grantor has the right on the movable asset but in reality, it defeats the objective because the encumbered movable assets are actually needed in the manufacturing process.

This probably is the most difficult question in implementing the Guide into the Korean legal system. The Guide separates the issue of creation and third-party effectiveness, whereas this is not the case in Korean law. Therefore, if the Guide is to be implemented under the current legal system, caution should be taken taking into consideration the existing framework. According to the Guide, the agreement would need to identify the parties and describe the secured obligation and the encumbered assets in a reasonable manner.[49] It should be in writing but may be oral if accompanied by transfer of possession.[50] The agreement may secure any type of obligation (present or future, determined or determinable, condition or unconditional, fixed or fluctuating) and may encumber any type of assets as had been discussed in the scope above.[51] A security right may be created not only in assets that exist or belong to the grantor at the time of the security agreement, but also in assets that do not exist or that the grantor does not yet own or have the power to encumber. Therefore, a single security agreement is sufficient to cover present and future or after-acquired assets.[52]

49) Recommendation 14 of the Guide.
50) Recommendation 15 of the Guide.
51) Recommendations 16 and 17 of the Guide.
52) Recommendation 17 of the Guide.

The Guide recommends that the security right should be created at the time of the conclusion of the security agreement, unless the grantor acquires the rights or the power to encumber the asset thereafter, in which the security right is created when the grantor acquires those rights or power.[53] Once a security right is created, it is effective as between the grantor and the secured creditor.[54]

According to the Guide, a security right should extend to the proceeds of encumbered assets unless otherwise agreed by the parties.[55] "Proceeds" refers to whatever is received in respect of the encumbered assets, including what is received as a result of sale or other disposition or collection, lease or licence of an encumbered asset, proceeds of proceeds, civil and natural fruits, dividends, distributions, insurance proceeds and claims arising from defects in, damage to or loss of an encumbered asset. A security right may be created in a tangible asset that is an attachment at the time of creation and/or continues in a tangible asset that becomes an attachment subsequently.[56] A security right

53) Recommendation 13 of the Guide.

54) Recommendation 30 of the Guide. However, third-party effectiveness is subject to further requirements.

55) Recommendation 20 of the Guide. Where proceeds in the form of money or funds credited to a bank account have been commingled with other assets of the same kind so that the proceeds are no longer identifiable, the amount of the proceeds immediately before they were commingled is to be treated as identifiable proceeds after commingling (so, if the value of the proceeds is 10 and the value of the total property is 20, 10 is identifiable proceeds). However, if, at any time after commingling, the total amount of the asset is less than the amount of the proceeds, the total amount of the asset at the time that its amount is lowest plus the amount of any proceeds later commingled with the asset is to be treated as identifiable proceeds.

56) Recommendation 21 of the Guide.

created in tangible assets before they are commingled in a mass or product continues in the mass or product, limited to the value of the assets immediately before they became part of the mass or product.[57)]

Asset-specific The Guide recommends that the law should recognize the effectiveness of a bulk assignment of receivables, an assignment of future, parts of and undivided interests in receivables as well as the effectiveness of an assignment of receivables despite an anti-assignment clause.[58)] A secured creditor with a security right in a receivable, a negotiable instrument or any other intangible asset shall automatically benefit from any personal or property right that secures payment or other performance of the receivable, the negotiable instrument or any other intangible asset.[59)] The Guide also recommends that the law should recognize the effectiveness between the grantor and the secured creditor with respect to a security right in a right to payment of funds credited to a bank account, notwithstanding an anti-assignment agreement.[60)] A beneficiary of an independent undertaking may create a security right in

57) Recommendation 22 of the Guide.

58) Recommendations 23 and 24 of the Guide.

59) Recommendation 25 of the Guide. If the personal or property right is an independent undertaking, the security right automatically extends to the right to receive the proceeds under the independent undertaking but does not extend to the right to draw under the independent undertaking. Similarly, this rule does not apply to a right in immovable property that under other law is transferable separately from a receivable, negotiable instrument or other intangible asset

60) Recommendation 26 of the Guide. An anti-assignment agreement refers to any agreement between the grantor and the depositary bank limiting in any way the grantor's right to create such a security right. However, the depositary bank has no duty to recognize the secured creditor and no obligation is otherwise imposed on the depositary bank with respect to the security right without the depositary bank's consent.

the right to receive the proceeds under an independent undertaking.[61] However, this is not a transfer of the right to draw under an independent undertaking.[62] Finally, a security right in a negotiable document shall extend to the tangible assets covered by the document, provided that the issuer is in possession of the assets, directly or indirectly, at the time the security right in the document is created.[63]

3. Third-party effectiveness and Priority

As to best facilitate the availability of secured credit, the Guide suggests that secured transaction laws should be structured to enable businesses to utilize the maximize value inherent in their movable property. In this regard, the Guide adopts two essential concepts: “priority” and “third-party effectiveness,” concepts also familiar in the

61) An “independent undertaking” means a letter of credit (commercial or standby), a confirmation of a letter of credit, an independent guarantee (including demand, first demand, bank guarantee or counter-guarantee) or any other undertaking recognized as independent by law or practice rules “Right to receive the proceeds under an independent undertaking” means the right to receive a payment due, a draft accepted or deferred payment incurred or another item of value, in each case to be paid or delivered by the guarantor/issuer, confirmer or nominated person giving value for a draw under an independent undertaking. The term also includes the right to receive payment in connection with the purchase by a negotiating bank of a negotiable instrument or a document under a complying presentation. The term does not include: (ⅰ) the right to draw under an independent undertaking; and (ⅱ) what is received upon honour of an independent undertaking. A security right in the right to receive the proceeds under an independent undertaking (as an original encumbered asset) is different from a security right in “proceeds” of assets covered in the Guide. Thus, what is received as a result of a complying presentation under an independent undertaking constitutes the “proceeds” of the right to receive the proceeds under an independent undertaking.

62) Recommendation 27 of the Guide.

63) Recommendation 28 of the Guide.

Korean legal system. The concept of priority allows for the concurrent existence of security rights having different priority status in the same assets, making it possible for a business to utilize the maximum possible value of its assets to obtain secured credit from multiple creditors using the same assets, while at the same time providing information regarding the priority of their security rights to other creditors. The concept of third-party effectiveness, which is envisaged in the Guide to be achieved generally by registration of a simple notice in a quick and inexpensive way, promotes legal certainty with regard to the relative priority status of rights of creditors and thus reduces the risks and costs associated with secured transactions. Although the two concepts may not be so different from those in Korean law, the method of achieving third-party effectiveness, which will be mentioned below, would need to be analyzed in more detail, as the Korean legal system does not differentiate between effectiveness between parties and third-party effectiveness where as the Guide does.

Third-party effectiveness Once a security right is created, it is effective as between the grantor and the secured creditor.[64] The Guide provides that the general method for achieving effectiveness against third parties is by registering a notice in the general security rights registry.[65]

It is suggested that different methods for achieving third-party effectiveness may be used for different types of assets.[66] A security right may be made

64) Recommendation 30 of the Guide.
65) Recommendation 32 of the Guide.
66) Recommendation 36 of the Guide.

effective against third parties by possession (tangible assets)[67]; possession of the document (tangible assets covered by a negotiable document); registration in a specialized registry or in the immovable property registry; or by control (funds credited to a bank account).[68]

Once a security right is effective against third parties, it remains effective against third parties even if there is a change in the method of achieving third-party effectiveness as long as there is no time lapse.[69] If there is a time lapse, third-party effectiveness may be re-established but it only takes effect from the time it is re-established.[70]

Third-party effectiveness of a security right in an encumbered asset is automatically extended to a security right in any proceeds of the encumbered asset provided that the proceeds are described in a generic way in a registered notice or on the condition that the proceeds consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.[71] Third-party effectiveness of a security right in a tangible asset, which become an attachment or becomes party of a mass or product, is also automatically extended.[72]

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67) A security right in tangible assets may be effective against third parties by registration or by the secured creditor's possession.

68) Recommendation 34 of the Guide.

69) Recommendation 46 of the Guide.

70) Recommendation 47 of the Guide.

71) Recommendation 39 of the Guide If the proceeds are not described in the registered notice or do not consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account, the security right in the proceeds is effective against third parties for [a short period of time to be specified] days after the proceeds arise and continuously thereafter, if it was made effective against third parties by one of the methods referred to he law before the expiry of that time period.

72) Recommendations 41 and 44 of the Guide.

Asset-specific The Guide recommends that the general registration rule shall apply to the third-party effectiveness of receivables and negotiable instruments. Third-party effectiveness of a security right in a receivable, negotiable instrument or any other intangible asset extends to any personal or property right that secures payment or other performance of the receivable, negotiable instrument or other intangible asset, without further action by either the grantor or the secured creditor.[73] Special rules apply to rights to payment of funds credited to bank accounts, proceeds under independent undertakings, negotiable documents or assets covered by negotiable documents. A security right in a right to payment of funds credited to a bank account may be made effective against third parties by registration or by the secured creditor obtaining control with respect to the right to payment of funds credited to the bank account.[74] A security right in a right to receive the proceeds under an independent undertaking may be made effective against third parties only by the secured creditor obtaining control with respect to the right to receive the proceeds under the independent undertaking.[75] A security right in a negotiable document may be made effective against third parties by registration or by the secured creditor's possession of the document.[76]

Priority The Guide suggests that provisions on the priority of a security right shall provide rules for determining the priority of a security right as against the rights of competing claimants in an efficient and predictable way and facilitate transactions by which a grantor may create

73) Recommendation 48 of the Guide.
74) Recommendation 49 of the Guide.
75) Recommendation 50 of the Guide.
76) Recommendation 51 of the Guide.

more than one security right in the same asset and thereby use the full value of its assets to obtain credit. Priority in the Guide refers to the right of a person to derive the economic benefit of its security right in preference to a competing claimant. By allowing ranking of several creditors with rights in the encumbered asset(s), it facilitates transaction by which the grantor may create more than one security right in the same asset and use the full value of its assets to obtain credit. In principle, priority as between competing security rights in the same encumbered assets is determined by the order of the security right achieving third-party effectiveness.

A brief summary of the priority rules as provided in Chapter V of the Guide is as follows[77]:

○ Between security rights that were made effective against third parties by registration of a notice, the order of their registration[78]

○ Between security rights that were made effective against third parties by means other than registration of a notice, the order of their third-party effectiveness[79]

○ Between a security right that was made effective against third parties by registration and a security right that was made effective against third parties by other means, the order of registration or third-party effectiveness, whichever occurs first[80]

77) It should be noted that these rules on priority are generally subject to the rules governing acquisition financing which provide more detailed provisions on the priority of acquisition security rights.

78) Recommendation 76 (a) of the Guide.

79) Recommendation 76 (b) of the Guide.

80) Recommendation 76 (c).

○ Between security rights that were made effective against third parties by registration in a specialized registry or notation on a title certificate, the order of registration or notation[81)]

○ To preserve the reliability of specialized registry, between a security right made effective against third parties by registration in a specialized registry or notation on a title certificate and a security right in the same asset, made effective against third parties by registration of notice in the general security rights registry or by means other than registration in a specialized registry or notation on a title certificate, the former[82)]

○ Between a security right and a preferential claim arising by operation of law, the latter[83)]

○ Between a security right made effective against third parties and the rights of an unsecured creditor, the former[84)]

○ Between a security right and the rights of a judgment creditor, the latter provided that the judgment creditor obtained the judgment and took the necessary steps to acquire rights by reason of the judgment before the security right was made effective against third parties[85)]

The priority of a security right is not affected by a change in the method by which it achieved third-party effectiveness, provided that there

81) Recommendation 77 (b)
82) Recommendation 77 (a)
83) Recommendation 83.
84) Recommendation 84.
85) Recommendation 84.

is no time lapse. Also, in principle, the priority of a security right extends to all secured obligations, regardless of the time they incurred[86] and all assets covered by the registered notice, irrespective of whether they are acquired by the grantor and came into existence before, at or after the time of registration.[87] However, the priority is limited to the maximum amount set out in the registered notice.[88]

Priority of rights of persons providing services with respect to an encumbered asset, a supplier's reclamation right, a security right in an attachment to immovable property, a security right in an attachment to movable assets, a security right in a mass or product are also provided in the law.[89]

Rights of transferees, lessees and licensees of an encumber asset If an encumbered asset is transferred, leased or licensed and a security right in that asset is effective against third parties at the time of the transfer, lease or licence), the transferee, lessee or licensee takes its rights subject to the security right except when: ⅰ) the grantor sold, disposed of, leased or licensed the encumbered asset with the secured creditor's authorization; or ⅱ) the buyer or the lessee of a tangible asset, in the ordinary course of the seller's business, does not have knowledge that the sale violates the rights of the secured creditor under the security agreement at the time of the sale.[90] Any person that subsequently

86) Recommendation 97 of the Guide.
87) Recommendation 99 of the Guide.
88) Recommendation 98 of the Guide.
89) Recommendations 85 to 92 of the Guide.
90) Recommendations 80 and 81 of the Guide. In principle, the knowledge of the

acquires a right in the asset from the above-mentioned transferee (lessee or licensee) also takes the asset free of the security right.[91]

Subordination A competing claimant with priority may at any time subordinate its priority unilaterally or by agreement in favour of any other existing or future competing claimant.[92] In this way, financiers may negotiate among themselves and with their borrowers to make possible transactions that otherwise would not be possible.

Asset-specific The Guide recommends that priority rules regarding security rights in a negotiable instrument[93], in a right to payment of funds credited to a bank account[94], in money[95], in a right to receive the proceeds under an independent undertaking[96], and in a negotiable document or tangible assets covered by a negotiable document[97] should also be provided in the law.

4. The Registry

The main purpose of a security rights registry is to provide a method of achieving third-party effectiveness, a reference point for determining priority and an objective source of information for third parties. However,

existence of a security right by a competing claimant should not affect and is irrelevant to priority. See recommendation 93 of the Guide.

91) Recommendation 82 of the Guide.
92) Recommendation 94 of the Guide.
93) Recommendations 101 and 102 of the Guide.
94) Recommendations 103 to 105 of the Guide.
95) Recommendation 106 of the Guide.
96) Recommendation 107 of the Guide.
97) Recommendations 108 and 109 of the Guide.

unlike traditional immovable property registries, the Guide does not perceive the legal consequence of registration in the registry to be the creation of a security right. To achieve the above-mentioned purposes, a registry system should ensure that the registration and searching process are simple, time and cost-efficient, user-friendly and publicly accessible.

From 1994, Korea started to computerize its real estate and legal person registry. However, no such registry exists for other type of assets with the exception of automobiles, commercial airplanes and such. Therefore, in order to, implement a secured transactions regime, a computer registry would need to be set up. Indeed, some scholars have emphasized the need for a general registry to publicize security rights in cases where the encumbered asset is a movable asset or a receivable.[98] They argue that mere notification of a transfer is not enough to be effective against third parties, especially in the case of bulk assignments, as it would be time and cost-consuming.

As seen above, the main method provided in the Guide for achieving third-party effectiveness of a security right is by registering a notice in the general security rights registry. It states that notices in the registry should only need to contain the following information: the identifier (i.e. name, possibly the joomindeungrokbeonho in Korea) and address of the grantor and the secured creditor; the description of the assets covered, the duration of the registration and the maximum amount for which the security right may be enforced.[99]

98) Kim Jae-Hyung, supra note 19, p 76-77.

99) Recommendation 57 of the Guide. This is to help facilitate subordinate lending.

The reason for this simplified structure is purely practical. It promotes access to secured credit. Title registries, like the traditional immovable property registries, require registration of documents (the original or copy of the security agreement) and are more suitable for high-value assets that exist at the time a security right is granted, and whose number or location does not change. Such an approach would be unnecessarily burdensome for financing of movable assets, fluctuating amounts of secured obligations, changing pools of encumbered assets (e.g. inventory) and future or after-acquired assets of the grantor. Thus, the registry system is designed to be more flexible, allowing interested parties to register or to search the record in a simple, quick and inexpensive manner.

Some of the key elements of the registry system as provided in Chapter Ⅳ are as follows[100]:

○ Notice registration would need authorization by the grantor in writing either before or after the registration.[101]

○ The record of the registry should be centralized and contain all notices with respect to security rights registered.[102]

○ Notices should be indexed and searchable according to the identifier of the grantor.[103]

However, another view is that such a statement would complicate financing as parties might inflate the amounts in the notices resulting in the limitation of the amount of credit available for lower-ranking secured creditors.

100) For operational framework of the registration and search process, see recommendation 54 of the Guide.

101) Recommendation 71 of the Guide. A written security agreement is sufficient to constitute authorization.

102) Recommendation 54 (e) of the Guide.

103) Recommendation 54 (h) of the Guide. Asset-based index is possible only for assets

○ Information provided in the registry should be available to the public and a search may be made without any need for justification.[104)]

○ Fees for registration and search should be minimal.[105)]

○ The registry system should be electronic and operate continuously except for scheduled maintenance[106)]

○ Some incorrect statements or insufficient description of encumbered assets should not render a registered notice ineffective[107)]

○ Secured creditors should be able to amend the registered notice in case of change of the grantor's identifier and the impact of a transfer of an encumbered asset on the effectiveness on the registration should be addressed.[108)]

○ Notices may be registered before or after creation of a security right or the conclusion of the security agreement[109)]

○ Procedures for cancellation or amendment of notices should be provided.[110)]

○ Allocation of responsibility for loss or damage caused by an error in the administration or operation of registration should be provided.[111)]

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that have a serial numbers.

104) Recommendations 54 (f) and (g) of the Guide.

105) Recommendation 54 i) of the Guide.

106) Recommendations 54 (j) and (l) of the Guide.

107) Recommendations 64, 65 and 66 of the Guide.

108) Recommendations 61 and 62 of the Guide.

109) Recommendation 67 of the Guide.

110) Recommendations 72 to 75 of the Guide.

111) Recommendation 56 of the Guide. If the system is designed to permit direct registr ation and search-ing by registry users without the intervention of registry personnel, the responsibility of the registry for loss or damage should be limited to system malfunction

As can be seen from above, the registry system recommended by the Guide does not differentiate between the types of encumbered assets. However, in the Korean legal system there is a differentiation between movable assets and receivables in many aspects and it should be considered whether a comprehensive registry system should be introduced. It may well be that respective registries for each type of assets would be sufficient. However, the fact that the registry recommended by the Guide provides a one-size-fit approach to all kinds of assets, making it unnecessary to develop new registries for every type of assets must not be forgotten.

5. Rights and Obligations of the parties to the Security Agreement and Third-party Obligors

Parties to the security agreement The Guide states in Chapter VI that the purpose of provisions on the rights and obligations of the parties is to enhance efficiency of secured transactions and to reduce transaction costs and potential disputes. Parties have the freedom to structure their security agreement in any way they wish so as to address their needs.[112] Because modern secured transactions regimes greatly emphasize flexibility, the Guide also adopts an approach that recognizes party autonomy, recognizing parties' ability to derogate from or vary by agreement the provisions of the secured transactions regime relating to their respective rights and obligation.[113] At the same time, the law recognizes that party

112) Recommendation 110 of the Guide.

113) Recommendation 10 of the Guide. Party autonomy is limited by certain specified

autonomy may have to be limited to prevent adverse affects to the rights of third parties.[114] As to accommodate modern business practices, the Guide also contains recommendations recognizing the ability of parties to conduct business using electronic communications.[115] This is especially meaningful as Korea signed the United Nations Convention on the Use of Electronic Communications in International Contracts in January 2008, joining 16 other member States as a signatory to this treaty.

The Guide recommends that the law should include a set of rules to advance a number of policy objectives, such as the reasonable allocation of responsibility for the care of the encumbered assets and the promotion of access to credit at affordable costs. Some of these rules regarding the duty of care of the person in possession of the encumbered assets and the duty of the secured creditor to return the encumbered assets or to terminate any notice on the record of the registry upon full payment are recognized as mandatory by nature.[116]

The Guide also provides other rules that shall be non-mandatory and are applicable prior to default in the absence of an agreement between the parties. Those rules deal with issues such as the right of the secured creditor to be reimbursed for reasonable expenses incurred for the preservation of the encumbered assets in its possession, as well as to make reasonable use

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mandatory rules that reflect strong policy considerations. The Guide also notes that an agreement between the grantor and the secured creditor does not affect the rights of any person that is not a party to that agreement.

114) *Ibid*.

115) Recommendations 11 and 12 of the Guide.

116) Recommendations 111 and 112 of the Guide.

of the encumbered assets in its possession and to inspect encumbered assets in the grantor's possession.[117)]

Asset-specific With respect to the mutual rights and obligations of the assignor and the assignee of a contractual receivable, the principles embodied in articles 12 to14 of the UN Assignment Convention should be reflected in the law. These articles deal with the agreement as sources of the rights and obligations of the assignor and the assignee, representations of the assignor, the independent right of the assignee to notify the debtor of the receivable to pay as instructed by the assignee and the right of the assignee as against the assignor to request payment and keep the proceeds of such payment.[118)]

Third-party obligors In the Guide, third-party obligors refer to obligors other than the debtor of the secured obligation (i.e. the debtor of the receivable, the obligor under a negotiable instrument, the depositary bank, the guarantor/issuer, confirmer or nominated person of an independent undertaking and the issuer of a negotiable document) The Guide in Chapter VII, provides that provisions on the rights and obligations of third-party obligors should enhance the efficiency of secured transactions where the encumbered asset is a payment obligation or other performance owed by a third party to the grantor. The Guides perceives that this objective could be achieved by providing rules relating to rights and obligations of parties to the assignment of a receivable and the protection

117) Recommendation 113 of the Guide.
118) Recommendations 114 to 116 of the Guide.

of the debtor of the receivable; rules to ensure the coherence of secured transactions law with other law relating to the rights and obligations arising under negotiable instruments and negotiable documents; and rules to ensure the coherence of the secured transactions regime with other law governing the rights and obligations of depositary banks, and of the guarantor/issuer, confirmer or nominated person under an independent undertaking. The Guides suggests asset-specific rules.

The debtor of the receivable With respect to the rights and obligations of the debtor of the assigned receivable, the Guide reflects the principles of articles 15 to 21 reflected in the UN Assignment Convention. The Guide recommends that provisions to deal with the protection of the debtor of the receivable, notification of assignment to the debtor, discharge of the debtor of the receivable by payment, defenses and rights of set-off of the debtor, waiver of defenses or rights of set-off, modification of the original contract and recovery by the debtor of payments made to the assignee should be provided.[119)]

The obligor under a negotiable instrument and the issuer of a negotiable document In order to ensure that the law does not undermine the negotiability of instruments as provided under the law governing negotiable instruments, the Guide recommends that a secured creditor's rights in a negotiable instrument are, as against the obligor under a negotiable instrument, subject to that law governing negotiable instruments.[120)] Similarly, a secured creditor's rights in a negotiable document are, as

119) Recommendations 117 to 123 of the Guide.
120) Recommendation 124 of the Guide.

against the issuer of a negotiable document, subject to that law governing negotiable documents.[121]

A depositary bank In order to avoid any interference with banking law and the bank-client relationship under that law, the Guide recommends that the creation of a security right in a right to payment of funds credited to a bank account should not affect the rights and obligations of a depositary bank without its consent.[122] For the same reason, the depositary bank's rights of set-off are not impaired by reason of any security right that a depositary bank may have in a right to payment of fund credited to a bank account.[123] Moreover, it recommends that a depository bank should not be obligated to pay any person other than the person who has control (i.e. the account holder or a person with whom the bank has concluded a control agreement with the consent of the account holder) nor to respond to request to any queries about whether a control agreement or a security right in its own favor exists and whether the grantor retains the right to dispose of the funds.[124] It also recommends that a depository bank should not be obligated to enter into a control agreement.[125]

The guarantor/issuer, confirmer or nominated person under an independent undertaking The Guide recommends that the law should provide a set of rules aimed at preserving the independence of the undertaking. Pursuant to

121) Recommendation 130 of the Guide.
122) Recommendation 125 (a) of the Guide.
123) Recommendation 125 (b) of the Guide.
124) Recommendation 126 of the Guide.
125) Recommendation 126 (c) of the Guide.

these rules, the rights of a guarantor/issuer, confirmer or nominated person and the rights of a transferee of that independent undertaking shall not be affected by the secured creditor's right in the proceeds under an independent undertaking.[126] The guarantor/issuer, confirmer or nominated person shall not be obligated to pay any person other than the person indicated under the independent undertaking.[127]

6. Enforcement

The Guide, in Chapter VIII, recommends that provisions on enforcement of security rights should provide clear, simple and efficient methods for the enforcement of security rights after debtor default,[128] methods designed to maximize the net amount realized from the encumbered assets[129], and expeditious judicial and, subject to appropriate safeguards, non-judicial methods for the secured creditor to exercise its rights.

In order to prevent the abuse of rights by any party, the Guide recommends a general standard of conduct. Enforcement of rights and performance of obligations should be in good faith and in a commercially reasonable manner.[130] Should a party fail to comply with this standard or

126) Recommendation 127 of the Guide.

127) A confirmer, a nominated person, a named beneficiary, an acknowledged transferee of the independent undertaking or an acknowledged assignee of the right to receive the proceeds under the independent undertaking. See recommendation 128 of the Guide.

128) "Default" is not defined in the Guide. It is left to the security agreement and the law governing that agreement

129) This benefits the grantor, the debtor or any other person that owes payment of the secured obligation, the secured creditor and other creditors with a right in the encumbered asset.

130) Recommendation 131 of the Guide.

any other obligation, it shall be liable for damages caused thereof.[131]

The Guide also recommends that party autonomy should be recognized in enforcement, which is essential for parties in structuring their transactions to address their particular needs.[132]

But at the same time, it also acknowledge certain limits. Accordingly, the general standard of conduct should not be waived or varied.[133] Waivers by the grantor or by the secured creditor of their rights (unilaterally or by agreement) should be permitted as long as they do not affect the rights of third parties.[134] To prevent the abuse of the secured creditor's dominant position in negotiations, the grantor (and any other person that owes payment or other performance of the secured obligation) shall not be allowed to waive its rights under the provisions on enforcement prior to default.[135]

The Guide recommends that the general rights of the secured creditor and the grantor, in the case of default, should be as follows:

The secured creditor may:[136]

○ obtain possession of a tangible encumbered asset;[137]

○ sell or otherwise dispose, lease or license an encumbered asset;[138]

131) Recommendation 136 of the Guide.
132) Recommendations 133 and 134 of the Guide.
133) Recommendation 132 of the Guide.
134) Recommendation 135 of the Guide.
135) Recommendation 133 of the Guide.
136) Recommendation 141 of the Guide.
137) Recommendations 146 and 147 of the Guide.
138) Recommendations 148 and 149 of the Guide.

○ propose to acquire an encumbered asset in total or partial satisfaction of the secured obligation;[139] and

○ enforce its security right as provided in the law or exercise any other right provided in the security agreement to the extent consistent with this law or other relevant law.

The grantor may:[140]

○ pay in full the secured obligation, including enforcement costs up to the time of full satisfaction and obtain a release of the encumbered assets from the security right;[141]

○ apply to the court or other authority for relief if the secured creditor is not complying with its obligations;[142]

○ propose to the secured creditor or reject the proposal of the secured creditor to accept the encumbered assets in total or partial satisfaction of the secured obligation;[143] and

○ exercise any other right provided in the security agreement or any law to the extent consistent with this law or other relevant law.[144]

After default, the secured creditor may exercise its rights mentioned above either by applying to a court or other authority or without such application.[145] Extra-judicial exercise is subject to the general standard of

139) Recommendations 156 to 158 of the Guide.
140) Recommendation 139 of the Guide.
141) Recommendations 139 and 140 of the Guide. This right may be exercised until the disposition, acceptance or collection of an encumbered asset by the secured creditor
142) Recommendation 139 (b) of the Guide.
143) ecommendatio 139 (c)
144) Recommendation 139 (d) of the Guide.
145) Recommendation 142 of the Guide.

conduct as well as other requirements in the law. For example, for extra-judicial possession, the grantor's consent, notice of default and of the secured creditor's intent to pursue extra-judicial possession to the grantor or any person in possession of the encumber asset is required.[146] For extra-judicial disposition, advance notice to interested parties and the distribution of proceeds of disposition is required.[147] The Guide also provides recommendations regarding rights acquired through judicial and extra-judicial disposition.[148]

Asset-specific Although the Guide perceives that the law shall apply to outright transfers of receivables, rules on enforcement should not apply with the exception of the general standard of conduct in the case of an outright transfer with recourse[149] and the right of the assignee to collect or otherwise enforce the assigned receivable and any personal or property rights securing the payment of the assigned receivable.[150]

The Guide provides that the secured creditor may collect or otherwise enforce its security right, after or before default with the agreement of the grantor, in:

○ a negotiable instrument, as well as any personal or property right securing payment of the negotiable instrument, subject to the law

146) Recommendation 147 of the Guide.

147) Recommendations 148 to 152 of the Guide.

148) Recommendations 160 to 163 of the Guide. Title or other right acquired through a judicial disposition is determined by the law applicable to execution proceedings. Title or other right acquired through an extra-judicial disposition in good faith is free of the rights of the enforcing secured creditor (but not of the rights of prior-ranking creditors).

149) Recommendations 131 and 167 of the Guide.

150) Recommendations 168 and 169 of the Guide.

governing negotiable instruments;[151]

○ distribution of proceeds of disposition where the encumbered asset is a receivable, negotiable instrument or other claim;[152]

○ a right to payment of funds credited to a bank account, subject to the rights of the depositary bank.[153] A secured creditor in control may enforce its security right extra-judicially[154] whereas a secured creditor who does not have control has to apply to a court or other authority unless the depositary bank agrees to out-of-court enforcement;[155]

○ a right to proceeds under an independent undertaking, subject to the rights of the guarantor/issuer, confirmer or nominated person;[156] and

○ a negotiable document and the goods covered by it, subject to the law governing negotiable documents.[157]

7. Acquisition Financing

The Guide in Chapter Ⅸ provides recommendations on acquisition financing. It is stated that the provisions of the law on acquisition financing should ⅰ) recognize the importance and facilitate the use of acquisition financing as a source of affordable credit, especially for small and medium-sized businesses; ⅱ) provide for equal treatment of all

151) Recommendations 170 and 171 of the Guide.
152) Recommendations 172 of the Guide.
153) Recommendation 173 of the Guide.
154) Recommendation 174 of the Guide.
155) Recommendation 175 of the Guide.
156) Recommendation 176 of the Guide.
157) Recommendation 177 of the Guide.

providers of acquisition financing; and iii) facilitate secured transactions in general by creating transparency with respect to acquisition financing. The Guide presents two options, a unitary approach and a non-unitary approach depending on how retention-of-title rights and financial lease right are treated in the jurisdiction.

Under the unitary approach, the Guide suggests that the law should provide the following set of rules with respect to acquisition financing:[158]

- ○ treatment of an acquisition security as a security right and application of the rules governing security rights, including those on creation, third-party effectiveness, registration, enforcement and the law applicable;
- ○ third-party-effectiveness and priority of an acquisition security right in consumer goods;
- ○ priority of an acquisition security right in a tangible asset and of a security right registered in a specialized registry or noted on a title certificate as against an acquisition security right;
- ○ priority between competing acquisition security rights;
- ○ priority of an acquisition security right as against the right of a judgment creditor and of an acquisition security right in an attachment to immovable property as against an earlier registered encumbrance in the immovable property;
- ○ priority of an acquisition security right in proceeds of inventory and in proceeds of tangible assets other than inventory or consumer goods; and

158) Recommendations 178 to 186 of the Guide.

○ treatment of an acquisition security right in insolvency proceedings.

Under the non-unitary approach, the Guide recommends that rules pertaining to retention-of-title rights and financial lease rights as a method of acquisition financing should also be developed. It is stated that these rules should produce functionally equivalent economic results as acquisition security rights and buyers or lessees should be able to create a security right in the tangible asset that is the object of the retention-of-title or the financial lease right.[159)]

Therefore, the Guide recommends the following set of rules with respect to acquisition financing:[160)]

○ third-party effectiveness of a retention-of-title or financial lease right in consumer goods and in a tangible asset

○ consequence of failure to achieve third-party effectiveness of a retention-of-title right or a financial lease right, ownership as against third parties passes to the buyer or lessee

○ third-party effectiveness of a security right in proceeds of a tangible asset subject to a retention-of-title right or a financial lease right

○ priority of the seller or lessor's security right in proceeds of inventory and of a tangible asset other than inventory or consumer goods

○ enforcement of a retention-of-title right or a financial lease right

○ treatment of a retention-of-title right or a financial lease right in insolvency proceedings.

159) Recommendations 189 and 190 of the Guide.
160) Recommendations 191 to 201 of the Guide.

8. Conflict of laws

The purpose of the provisions on conflict-of-laws, whether enacted as part of this law or another law of the State, is to determine the law applicable to the creation, third-party effectiveness and priority of a security right, and the pre- and post-default rights and obligations of the grantor, secured creditor and third parties. These rules clarify where a secured creditor has to register and determines the territorial scope of application of the substantive law.

The Guide recommends that the law applicable to the creation, third-party effectiveness and priority of a security right in a tangible asset should be the law of the state where the assets are located.[161] However, if the tangible asset is of a type ordinarily used in more than one State, the law applicable should be the law of the grantor's location.[162] For security rights in a tangible asset subject to registration in a specialized registry or notation on a title certificate, the law applicable should be the law of the State under whose authority the registry is maintained or the title certificate is issued.[163] This general rule also applies to negotiable instruments and negotiable documents.

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161) Recommendation 203 of the Guide.

162) Recommendation 204 of the Guide. For purposes of the conflict-of-laws rules, the grantor's location is the State in which it has its place of business. If the grantor has multiple places of business, the place where central administration is exercise is the grantor's location. If it doesn't have one, the habitual residence of the grantor is the grantor's location. See recommendation 219 of the Guide.

163) Recommendation 205 of the Guide.

With regards to a tangible asset in transit or for export, the Guide recommends that a security right in that tangible asset may be created and made effective against third parties under this law or under the law of the State of its ultimate destination.[164]

It is also recommended that the law applicable to the creation, third-party effectiveness and priority of a security right in an intangible asset should be the law of the grantor's location.[165] This general rule shall also apply to receivables. For example, the law applicable to rights in receivables arising from the sale, lease or security agreement relating to immovable property should be the law of the assignor's location.[166]

The law should also provide provisions for the law applicable to a security right in a right to payment of funds credited to a bank account (two approaches: the law of the State in which the bank has its place of business or the law of the State expressly stated in the account agreement as the States whose law governs the account agreement or another law)[167] and a security right in the fright to receive the proceeds under an independent undertaking (law specified in the independent undertaking)[168] and a security right in proceeds.[169]

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164) Recommendation 207. The latter is provided that the asset reaches that State within a certain period after creation.

165) Recommendation 208 of the Guide.

166) Recommendation 209 of the Guide.

167) ecommendatio 210

168) ecommendatio 212

169) ecommendatio 215.The law applicable to the creation of a security right in proceeds is the law applicable to the creation of the security right in the original encumbered asset from which the proceeds arose; an he law applicable to the third-party effectiveness and priority of a security right in proceeds is the law applicable to the

The law applicable to the mutual rights and obligations of the grantor and the secured creditor arising from the security agreement should be the law chosen by them, and in the absences of the choice of law, the law governing the security agreement.[170]

The law applicable to issues relating to enforcement of a security right in a tangible asset should be the law of the State where enforcement takes place.[171] For a security right in an intangible asset, the law applicable to the enforcement should be the law applicable to the priority of the security right, which is generally the law of grantor's location.[172]

9. Transition

The Guide provides that the law should provide provisions facilitating a fair and efficient transition to the law from the regime in force before the effective date of this law. An effective date (a date subsequent to its enactment on which it comes into force) would need to be specified and this law should apply to all transactions within its scope, whether entered into before or after that date.[173]

However, some exceptions are provides. This new law shall not apply to actions (litigation or alternate dispute resolution proceedings) that were commenced before the effective date. With regard to creation, the prior

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third-party effectiveness and priority of a security right in an asset of the same kind as the proceeds.

170) ecommendatio 216

171) ecommendatio 218

172) *Ibid.*

173) Recommendation 228 of the Guide.

law shall determine whether a security right was created before the effective date.[174] A different approach is taken with respect to third-party effectiveness and priority. The law should provide that a security right effective under prior law remains effective against third parties only during the transition period.[175] To remain effective against third parties beyond the transition period, a security right has to be made effective against third parties under this law during the transition period.[176] Similarly, as to issues of priority, the new law shall govern priority unless all competing rights have been created and made effective against third parties before the effective date of this law and the status of all those rights have not changed since the effective date.[177] The recommendations set forth in Chapter XI would seem to facilitate a smooth transition from the current regime into a reformed regime should this become necessary.

10. The impact of insolvency on security rights

With respect to the treatment of security rights in case of insolvency of the grantor, it is recommended that the law reflect the principles of

174) Recommendation 230 of the Guide. This is to ensure that pre-effective date relations hips between grantors and secured creditors are not unsettled against their expectations b y the new law. If parties wish to benefit from the new law, they can always re-establi sh their rights under the new law.

175) Recommendation 231 of the Guide. If the time it would cease to be effective against third parties under prior law is earlier than the end of the transition period, that time.

176) Ibid.

177) Recommendations 232 to 234 of the Guide.

the UNCITRAL Legislative Guide on Insolvency Law ("the Insolvency Guide").[178] Reference is made to the insolvency of the grantor because,

178) The following are the principles to be reflected in the law. Numbers in parentheses refer to the corresponding recommendation in the Insolvency Guide. In principle, encumbered assets are part of the estate (35) and individual actions even by secured creditors to perfect or enforce security rights are stayed. (39, 46) If, however, a security right was already effective against third parties at the time of commencement of an insolvency proceeding, the secured creditor may thereafter take action to preserve the third-party effectiveness of the security right to the extent and in the manner permitted by secured transactions law. (177) The stay of individual actions remains effective throughout the insolvency proceedings until the court grants relief from the stay, a reorganization plan becomes effective or, in liquidation proceedings, a fixed time period expires, unless it is extended by a court. (49A) secured creditor may apply to a court to provide protection of the value of the encumbered assets through, for example, cash payments by the estate, provision of additional security rights or other means determined by the court.(50) A secured creditor may also seek from a court the lifting of the stay if, for example, the encumbered assets are not necessary for the reorganization of the grantor's business, the value of the encumbered assets is diminishing, while the secured creditor is not protected against diminution of value, or in reorganization, a plan is not approved within the prescribed time limits. (51) The insolvency administrator may use or dispose of the encumbered assets free of any security rights in the ordinary course of business, except cash proceeds. Cash proceeds may be used or disposed of if the secured creditor consents, the secured creditor was given notice and an opportunity to be heard by a court and the interests of the secured creditor will be protected against diminution in the value of the cash proceeds. (52, 59) The insolvency administrator may also use and dispose of encumbered assets even outside the ordinary course of business subject to certain conditions. Such conditions include adequate notice to creditors, an opportunity for them to be heard by a court and the preservation of the priority of the security rights in the proceeds of the sale othe encumbered assets. (52, 55, 58)The insolvency administrator may also give further security rights in already encumbered assets to secure post-commencement finance. Such further security rights do not have priority over existing security rights unless the existing secured creditor agree to subordinate their rights to the rights of the post-commencement financiers or the court authorizes the creation of post-commencements security rights with priority over pre-commencement security rights. (53, 65, 66 and 67) Furthermore, the insolvency administrator may relinquish assets, provided that notice is given to creditors and they have an opportunity to object. Such notice is not necessary where a secured claim exceeds the value of the encumbered assets and the assets are not required for the reorganization or the sale of the business as a going concern. (62) While the Insolvency Guide recognizes that the effective

if the debtor is a different person and becomes insolvent, the creditor would become an unsecured creditor in the insolvency proceeding.

The Guide provides additional recommendation for the insolvency law with regards to assets acquired after commencement of insolvency proceedings, automatic termination clauses, third-party effectiveness and priority of a security in insolvency proceedings, effect of a subordination agreement, costs and expenses of maintaining value of the encumbered asset in insolvency proceedings and valuation of encumbered assets in reorganization proceedings.[179]

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creation of a security right is subject to law other than insolvency law, a security agreement may, under the applicable insolvency law, be subject to avoidance on the same grounds as any other transaction (e.g. it is a preferential or fraudulent transfer taking place in the suspect period)(88) As encumbered assets are part of the estate, subject to stay and other limitations, secured creditors should have a right to participate in the insolvency proceedings and be heard on any issue that affects its rights and obligations. For example, a secured creditor may object to any act that requires court approval, request review by a court of any act for which court approval was not required or not requested or request any relief available to the secured creditor in the insolvency proceedings. (137) If voting on approval of a reorganization plan is conducted by reference to classes, the Insolvency Guide leaves it to each insolvency law to determine how the vote would be treated. However, at least one class of creditors whose rights are modified or affected by the plan must approve it. In addition, if the insolvency law requires court confirmation of an approved plan, the court can confirm the plan, provided that: ⅰ) the necessary approvals have been obtained and the approval process was properly conducted; ⅱ) creditors will receive under the plan at least as much as they would have received in liquidation, unless they have specifically agreed to receive less; ⅲ) the plan does not contain provisions contrary to law; ⅳ) administrative expenses will be paid in full, unless otherwise agreed by the holder of such a claim; and ⅴ) unless otherwise agreed, the ranking of a class of creditors that has voted against the plan will not be changed and distribution to that class under the plan will be in line with that ranking. (152) In determining the liquidation value of encumbered assets in are organization proceeding, consideration should be given to the use of the assets and the purpose of the valuation. (181)

179) Recommendations 235 to 242 of the Guide.

In the case of Korea, it should be noted that its insolvency law had been legislated partially based on the UNCITRAL Model Law on Cross-Border Insolvency. As the UNCITRAL Legislative Guide on Insolvency is also available, any reform of the secured transactions regime should take into consideration the relevant aspects of the insolvency law.

Ⅴ. Conclusion

If we look back at the report of the thirty-fourth UNCITRAL session in 2001, it is stated that the prevailing view of the Commission was that work on security interests should be undertaken in view of the beneficial economic impact of a modern secured credit law.[180] This was because experience had shown that deficiencies in this area could have major negative impacts on a country's economic and financial system.[181] It was also noted that an effective and predictable legal framework had both short- and long-term macroeconomic benefits.[182] In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth.[183] The conclusion was that, without access to affordable credit, economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential.

180) Official Records of the General Assembly, Fifty-sixth Session, Supplement No. 17 (A/56/17), para. 351.

181) Ibid.

182) Ibid.

183) Ibid.

Seven years have passed since the Commission took note and circumstances have not changed. In fact, the same words could be repeated in the context of the recent financial crisis.

As mentioned in the introduction, the Korean legal system on secured transactions is in need of significant reforms.[184] Although, it may be suggested that the Guide contains some recommendations that are too patently different from the Korean civil law, it is needless to say that the Guide provides some insightful and challenging information.[185]

The regime provided in the Guide is a functional, integrated and comprehensive security system. Its goal is to provide an efficient regime that enhances the provision of low-cost credit to businesses and consumers. However, it has it disadvantages. First, this approach requires significant re-characterization of certain transactions (for example transfer of title or retention of title as a security device) in Korea meaning that it would require adjustments to the basic legal logic that has heretofore underpinned the law relating to security rights. Second, the integrated and comprehensive approach is mainly based on the assumption that the new regime will be brought into force in a single piece of legislation. For Korea, this will involve significant adjustment to the manner in which their civil codes, commercial codes and other statutes are organized and would result in the overhaul of the entire civil law system.

184) Kim Jae Hyung, "Yangdodambojedoeui Kaeseonbangan Deunrokjedoeul doibe kwanhan shiron," Minsabubhak Vol. 30, January 2005.

185) Ibid. p 1.

Nonetheless, the single and comprehensive framework should be sought for its advantages. If Korea is able to reform its legal regime into something that resembles the law recommended in the Guide, all relevant statutes dealing with non-possessory security rights (which are often great in number) would be merged into one text, an approach that ensures comprehensiveness, consistency and transparency of the rules. Rules on possessory security rights, especially the possessory pledge, may be covered and at the same time adapted to contemporary requirements. Title devices, such as transfer for security purposes and retention of title, may be integrated into the system in a way that not only gives sellers the protection they desire, but also enables buyers to use whatever value they have acquired in assets being purchased to obtain additional credit.

Moreover, the disadvantages mentioned above could be eliminated by carefully developing a framework for functional, integrated and comprehensive regime of security rights. For example, it would be possible to achieve most of the advantages while avoiding most of the disadvantages through: ⅰ) a comprehensive reform of existing laws relating to security rights, title devices serving security purposes, the assignment of receivables and financial leases; and ⅱ) the enactment of specific statutory rules to regulate contractual practices that have been developed to overcome gaps in the law. This is not to minimize the effort required to do so in a manner that would achieve consistency, transparency, efficiency and the establishment of genuine competition among all providers of credit on the basis of price.

The following question would be how to implement the functional, integrated and comprehensive regime. The extreme approach would be to abolish all types of rights serving security purposes sot that specific transactions and fin would be subsumed into a single, uniform notion of security rights.

A single set of rules would apply to all secured transactions because there would only be one type of security device available. However, this is somewhat unrealistic in the context of Korea. It should be suggested that the use of old security devices, such as pledge, transfer of title for security purposes and retention of title be to preserved and permitted even when enacting a functional, integrated and comprehensive regime. However, their creation and effects as security rights would be subject to a functional, integrated and comprehensive set of rules, even though, for other purposes they would continue to be subject to other rules. This approach would make it possible to maintain a conceptual diversity of security devices and other contractual arrangements that may be used for purposes of security, and yet provide for a common set of rules governing creation, third party-effectiveness, priority and enforcement.