United Nations A/CN.9/WG.VI/WP.71/Add.5

General Assembly

Distr.: Limited
19 September 2016

Original: English

United Nations Commission on International Trade Law
Working Group VI (Security Interests)
Thirtieth session
Vienna, 5-9 December 2016

Draft Guide to Enactment of the UNCITRAL Model Law on Secured Transactions

Note by the Secretariat

Addendum

Contents

V.16-05947 (E)

Chapter VI. Rights and obligations of the parties and third-party obligors

Section I. Mutual rights and obligations of the parties to a security agreement

A. General rules

Article 52. Sources of mutual rights and obligations of the parties

1. Article 52 is based on recommendation 110 of the Secured Transactions Guide (see chap. VI, paras. 14 and 15), which in turn is based on article 11 of the Assignment Convention. Paragraph 1 is intended to reiterate the principle of party autonomy enshrined in article 3. Paragraph 2 is intended to give legislative strength to trade usages and practices, which may not be generally recognized in all States.

2. With the exception of certain mandatory rules included in chapter VI (see arts. 3, para. 1, 53, 54 and 72, para. 3), the parties are given wide latitude to tailor their security agreement and their usage and practices to the transaction at hand in order to most effectively and efficiently facilitate their respective commercial goals. The other articles of chapter VI are non-mandatory rules and apply where the parties have not provided otherwise in the security agreement. For this reason, a reference to contrary agreement of the parties, which was included in the recommendations of the Secured Transactions Guide and the provisions of the Assignment Convention on which the provisions of this chapter are based, has been deleted (see, for example, article 57, recommendation 114 of the Secured Transactions Guide and article 12 of the Assignment Convention).

Article 53. Obligation of the party in possession to exercise reasonable care

3. Article 53 is based on recommendation 111 of the Secured Transactions Guide (see chap. VI, paras. 24-31). It sets forth the rule that a grantor or secured creditor in possession of a tangible asset (which under the definition in art. 2, subpara. (ll), includes money, negotiable instruments, negotiable documents and certificated non-intermediated securities) must exercise reasonable care to preserve the asset. Any other person in possession of an encumbered asset may also be obliged to take reasonable care to preserve the encumbered assets under other law.

4. What constitutes “reasonable care” in a given case depends upon the nature of the encumbered asset. Thus, reasonable care may mean something different with respect to equipment, inventory, crops or live animals. Preservation of the asset normally includes preservation of its value. The obligation to preserve the value of the asset may also arise under article 4, according to which a party should act in good faith and in a commercially reasonable manner. Although physical preservation of a tangible asset would, in most cases, have the effect of preserving the asset’s value, preservation of the asset’s value may go beyond the physical preservation of the asset. For example, if a secured creditor has possession of certificated non-intermediated shares of a company, the secured creditor may be required in particular circumstances to exercise certain rights attached to the shares

to preserve their value. However, preservation of the value of the encumbered assets may only include measures that are within the control of the person in possession.

5. Article 53 and a rule of law relating to securities along the lines of article 5(1) of the Financial Collateral Directive ("FCD"), which gives a secured creditor the right to use securities in its possession, should be read together and their relationship would be a matter of interpretation under the rules of the applicable law (under the FCD, "financial collateral" may consist of "cash", "credit claims" and "financial instruments", and "financial instruments" may be either intermediated or non-intermediated securities, as long as they are "negotiable on the capital market" or "normally dealt in").

Article 54. Obligation of the secured creditor to return an encumbered asset

6. Article 54 is based on recommendations 112 and 72 of the Secured Transactions Guide (see chap. VI, paras. 35-39). It provides that, once a security right in an encumbered asset is extinguished, a secured creditor in possession of the asset must return it to the grantor or, if the secured creditor so agrees, deliver it to a person designated by the grantor. In some States, delivery to a person designated by the grantor may be viewed as a means of returning the asset to the grantor. In any case, the additional cost then incurred by the secured creditor should be borne by the grantor in the same way as performance costs are normally payable by the grantor (for the secured creditor's obligation to register an amendment or cancellation notice, see art. 20, paras. 1, 2 and 3 of the Model Registry Provisions). A security right generally will be deemed to have been extinguished once the secured obligation has been paid in full or otherwise satisfied in full, and all further commitments to extend credit to the debtor have terminated.

7. Article 54 deals with a situation in which the secured creditor is in possession of an asset and therefore does not address the obligation of a secured creditor to withdraw any notification that it has given to the debtor of the receivable. However, the grantor is protected in this regard by article 59, paragraph 2, and article 79, paragraph 2 (b), which require the secured creditor to return to the grantor any surplus proceeds it receives. It should also be noted that: (a) article 54 does not apply to receivables or other intangible assets, because they cannot be the subject of physical possession (see art. 2, subpara. (z)); and (b) the question of whether a secured creditor should return securities equivalent to those received is a matter for the parties and other law (see, for example, art. 5(2) FCD).

Article 55. Right of the secured creditor to use and inspect an encumbered asset, and to be reimbursed for expenses

8. Article 55 is based on recommendation 113 of the Secured Transactions Guide (see chap. VI, paras. 50-65). It provides that a secured creditor not only has certain obligations (described in arts. 53 and 54), but also certain rights (in addition to its enforcement rights). Under paragraph 1 (a), a secured creditor in possession has the right to be reimbursed for the reasonable expenses incurred to preserve an encumbered asset in accordance with article 53. Under paragraph 1 (b), a secured creditor in possession may make reasonable use of an encumbered asset, so long as it applies any revenues generated from the use to the payment of the obligation secured by the asset.

9. Finally, under paragraph 2, where an encumbered asset is in the possession of the grantor, the secured creditor has the right to inspect the asset. As this article is subject to the general standard of commercial reasonableness and good faith set forth in article 4, the right to inspect may only be exercised at reasonable times and in a commercially reasonable manner. The application of this standard depends upon the circumstances. For example, in extreme cases, such as where the debtor is in default or the secured creditor has reason to believe that the physical condition of the collateral is in jeopardy or has been, or is about to be, removed from the State of its location, the secured creditor may be justified to demand an immediate inspection.

Article 56. Right of the grantor to obtain information

10. Article 56 is a new provision intended to provide the grantor (other than the transferor in an outright transfer of a receivable) with the right to obtain information from a secured creditor (other than a transferee under an outright transfer of a receivable) as to the amount of the secured obligation or the assets encumbered at a certain point of time. This information may be necessary where the grantor is interested in obtaining credit against the security of assets that are already encumbered and the potential third-party creditor requests that information (this does not apply to a transferor of a receivable, as such a transferor retains no right in the receivable and thus may not create a security right in it under art. 6, para. 1). The enacting State may wish to extend that right to third-party creditors (e.g. judgment creditors). Other matters, such as the legal consequences of the secured creditor's failure to comply with a request for information or to give accurate information are left to other law.

B. Asset-specific rules

Article 57. Representations of the grantor of a security right in a receivable

11. Article 57 is based on recommendation 114 of the Secured Transactions Guide (see chap. VI, para. 73), which in turn is based on article 12 of the Assignment Convention. It provides that, when a grantor grants a security right in a receivable, the grantor is deemed to make various representations to the secured creditor at the time the security agreement is concluded. In particular, under paragraph 1, the grantor represents that it has not previously created a security right in the receivable in favour of another secured creditor, and that the debtor of the receivable will not have any defences or rights of set-off with respect to the receivable (e.g. that the grantor will fully perform the contract giving rise to the receivable and any other contract it has entered into with the debtor of the receivable). Under paragraph 2, the grantor does not represent that the debtor of the receivable has, or will have, the ability to pay the receivable (as this is beyond the grantor's control). As already noted (see para. 2 above), article 57 is not a mandatory law rule and, as it often happens in a factoring transaction, the grantor may warrant the solvency of the debtor of the receivable on the date the receivable is sold to the factor.

12. The representation that the grantor has the right to create a security right was not carried over from recommendation 114 of the Secured Transactions Guide into

article 57, to avoid giving the impression that it applies to security rights created only in receivables. As a result, the matter is left to general contract law. It should be noted, however, that even in the case of an anti-assignment agreement between a grantor and a secured creditor, the grantor still has rights in the receivable and the power to encumber it, and thus may create a security right in the receivable (see art. 6, para. 1, and A/CN.9/WG.VI/WP.71/Add.1, para. 52).

Article 58. Right of the grantor or the secured creditor to notify the debtor of the receivable

13. Article 58 is based on recommendation 115 of the Secured Transactions Guide (see chap. VI, paras. 74 and 75), which is based on article 13 of the Assignment Convention. Paragraph 1 provides that, when a security right has been created in a receivable, either the grantor or the secured creditor has the right to notify the debtor of the receivable of the existence of the security right and send a payment instruction; however, once notification of the security right has been received by the debtor of the receivable, only the secured creditor may send a payment instruction (under art. 62, a notification or a payment instruction is effective only when received by the debtor of the receivable).

14. It should be noted that a payment instruction is treated as a notion distinct from notification, because: (a) a notification may not contain a payment instruction (for example, because the secured creditor may have obtained control of the grantor's bank account to which debtors of receivables have been instructed by the grantor to pay); (b) no notification may be given (for example, because the transaction involved is a non-notification factoring or undisclosed invoice discounting transaction); and (c) the secured creditor may need to change its payment instructions and thus there may be more than one payment instruction.

15. Paragraph 2 provides that a notification sent in breach of an agreement between the grantor of the security right and the secured creditor is nevertheless effective for the purposes of article 64, which precludes the grantor from raising, after receiving notice of the security right, certain rights of set-off with respect to the receivable that became available to the grantor after it received notice of the security right (see para. 35 below).

Article 59. Right of the secured creditor to payment of a receivable

16. Article 59 is based upon recommendation 116 of the Secured Transactions Guide (see chap. VI, paras. 76-80), which in turn is based on article 14 of the Assignment Convention. Any changes made are intended to clarify the text, but not to change its policy. The article establishes the right of the secured creditor to receive the proceeds of a receivable in which it holds a security right as against the grantor of the security right.

17. Paragraph 1 provides that, regardless of whether notification of the security right has been sent to the debtor of the receivable, the secured creditor is entitled to retain: (a) the proceeds of any full or partial payment of the receivable made to the secured creditor, as well as any tangible assets (such as inventory) returned to the secured creditor in respect of the receivable; (b) the proceeds of any full or partial payment of any receivable made to the grantor (as well as any tangible assets

returned to the grantor); and (c) the proceeds of any full or partial payment of any receivable made to another person (as well as any tangible assets returned to that person) if the right of the secured creditor has priority over the right of that person.

18. Paragraph 2 reflects normal practice in secured transactions relating to receivables in which the secured creditor may have the right to collect the full amount of the receivable owed, plus any interest payable under contract or by law, but has to account for and return to the grantor any balance remaining after payment of the secured obligation (see also art. 79, para. 2). Of course, in the case of an outright transfer of a receivable by agreement, the transferee may retain the amount collected as it has become the owner of the receivable.

Article 60. Right of the secured creditor to preserve encumbered intellectual property

19. Article 60 is based on recommendation 246 of the Intellectual Property Supplement (paras. 223-226). It recognizes the effectiveness of an agreement between the grantor of a security right in intellectual property and the secured creditor that the secured creditor may take the necessary steps to preserve the value of the intellectual property, such as making any necessary registration (such as a patent registration) and initiating actions to prevent infringement by third parties.

20. Although articles 3 (party autonomy) and 53 (obligation to preserve an encumbered asset) may be generally sufficient to ensure that the secured creditor may take these steps, article 60 has been included in the Model Law, because, in an intellectual property right context, these rights are normally rights of the intellectual property owner.

Section II. Rights and obligations of third-party obligors

A. Receivables

Article 61. Protection of the debtor of the receivable

21. Article 61 is derived from recommendation 117 of the Secured Transactions Guide (see chap. VII, para. 12), which in turn is based on article 15 of the Assignment Convention. Paragraph 1 sets forth the general principle that the creation of a security right in a receivable does not affect the rights or obligations of the debtor of the receivable, unless the debtor of the receivable consents. So, for example, the creation of a security right cannot change the payment terms of a contract giving rise to a receivable (e.g. the amount or the time of payment).

22. To implement the general principle of paragraph 1, paragraph 2 provides that, to enable the secured creditor to exercise its security right, a payment instruction (which is treated as a notion distinct from notification; see para. 14 above) may change the person, address or account to which the debtor of the receivable is required to make payment, but it may not change: (a) the currency in which the receivable is to be paid, as specified in the contract giving rise to the receivable; or (b) the State in which the payment is to be made, as specified in the contract giving

rise to the receivable, to a State other than that in which the debtor of the receivable is located.

Article 62. Notification of a security right in a receivable

23. Article 62 is based on recommendation 118 of the Secured Transactions Guide (see chap. VII, paras. 13-16), which in turn is based on article 16 of the Assignment Convention. It describes the requirements for an effective: (a) notification of a security right in a receivable; or (b) payment instruction (a payment instruction is treated as a notion distinct from notification, see para. 14 above).

24. Under paragraph 1, for the effectiveness of a notification or a payment instruction, it must be "received" by the debtor of the receivable. In addition, a notification or payment instruction must reasonably identify the receivable and the secured creditor, and be in a language reasonably expected to inform the debtor of its contents. On this latter point, paragraph 2 makes it clear that the language of the contract giving rise to the receivable is always sufficient. Under paragraph 3, a notification or payment instruction may relate not only to receivables in existence at the time the notification or payment instruction is given, but also may relate to receivables arising thereafter.

25. Paragraph 4 addresses a scenario where a receivable is the subject of subsequent security rights (e.g., subsequent security assignments or outright transfers). For example, where A creates a security right in its receivables and then transfers the obligation secured by them to B, who also creates a security right in the receivables and then transfers the secured obligation to C, who also creates a security right in the receivables in favour of D, notification of the debtor of the receivables relating to the security right created by C in favour of D constitutes notification of all prior security rights created by A and B.

Article 63. Discharge of the debtor of the receivable by payment

26. Article 63 is based on recommendation 119 of the Secured Transactions Guide (see chap. VII, paras. 17-20), which in turn is based on article 17 of the Assignment Convention. It sets forth the rules affecting when and how a receivable is discharged by payment.

27. Paragraph 1 embodies the basic principle that, until the debtor of the receivable receives notification of a security right in a receivable, it may be discharged by payment in accordance with the contract giving rise to the receivable. Where the contract is a sales contract, this means payment to the seller. However, under paragraph 2, once the debtor receives notification of a security right, it can only be discharged by paying either the secured creditor or another party, as instructed by the secured creditor in the notification or as subsequently instructed by the secured creditor in a written payment instruction received by the debtor. However, the rule in paragraph 2 is subject to a number of qualifications that are set forth in paragraphs 3-8.

28. First, under paragraph 3, if the debtor of the receivable receives more than one payment instruction relating to a single security right in the same receivable created by the same grantor, it is discharged by paying in accordance with the last payment instruction received from the secured creditor before payment, as the last

payment instruction will be the most recent (a payment instruction is treated as a notion distinct from notification, see para. 14 above).

29. Second, under paragraph 4, if the debtor receives notification of more than one security right in the same receivable created by the same grantor, it is discharged by paying in accordance with the first notification received, on the theory that the security right covered by the first notification will probably have priority over the subsequent security right under the Model Law's priority rules. It should be noted that the debtor of the receivable is discharged even if the first notification does not relate to the security right with priority, since the debtor cannot be required to determine which security right has priority. In such a case, the secured creditor with a security right that has priority will have to claim the proceeds of payment from the creditor to whom the debtor paid.

30. Third, under paragraph 5, if the debtor receives notification of one or more subsequent security rights in the same receivable, it is discharged by paying in accordance with the notification of the last of such subsequent security rights (i.e. where A creates a security right in favour of B, and B creates a security right in favour of C). The reason is that the last in such a series of successive secured creditors will be the actual holder of the security right.

31. Fourth, under paragraph 6, where the debtor receives notification of a security right in a part of, or an undivided interest in, one or more receivables, the debtor has a choice. It may be discharged by paying either in accordance with the notification or in accordance with paragraph 1 as if the debtor has not received the notification. However, if the debtor chooses the first of these alternatives, under paragraph 7, it is discharged only to the extent of the part or undivided interest paid.

32. Finally, under paragraph 8, if the debtor receives notification from a person other than the initial creditor of the receivable and wants to make sure that that person is a secured creditor entitled to payment, the debtor may request from the person that sent the notification to provide, within a reasonable time, adequate proof of the creation of the security right (including a security right granted by the initial or a subsequent secured creditor). If the secured creditor fails to provide such proof, the debtor may pay as if it had not received such notification. For this purpose, under paragraph 9, adequate proof includes any writing from the grantor that indicates that a security right has been created (e.g. a security agreement).

33. Paragraph 10 is intended to preserve any other ground for discharge based on payment to the person entitled to payment under other law (e.g. payment to a competent judicial or other authority, or to a public fund).

Article 64. Defences and rights of set-off of the debtor of the receivable

34. Article 64 is based on recommendation 120 of the Secured Transactions Guide (see chap. VII, para. 21), which in turn is based on article 18 of the Assignment Convention.

35. Paragraph 1 (a) preserves for the debtor all defences and rights of set-off arising from the contract giving rise to the receivable, including any other contract that was part of the same transaction, as if the security right had never been created and the claim were made by the grantor. Paragraph 1 (b) ensures that the debtor of

the receivable can assert against the secured creditor any other right of set-off that was available to the debtor at the time it received notification of the security right. This means, however, that the debtor may not assert a right of set-off that arises subsequent to such notification. Under article 65, the debtor may waive its defences and rights of set-off.

36. Paragraph 2 provides that paragraph 1 does not give the right to the debtor of the receivable to raise against the secured creditor as a defence or right of set-off the breach of an agreement by the grantor limiting the grantor's right to create a security right. Otherwise, the validation of a security right under article 13 notwithstanding such an agreement would be meaningless.

Article 65. Agreement not to raise defences or rights of set-off

37. Article 65 is based on recommendation 121 of the Secured Transactions Guide (see chap. VII, para. 22), which in turn is based on article 19 of the Assignment Convention. Paragraph 1 provides that the debtor of the receivable may agree, in a writing signed by it, not to raise the defences and rights of set-off permitted by article 64. The secured creditor is entitled to invoke the benefit of such an agreement even though it was not a party to it. Under paragraph 2, any modification to such an agreement must also be in a writing signed by the debtor of the receivable and is effective as against the secured creditor only if the secured creditor consents or, in the case of a receivable that has not been earned yet by performance, a reasonable secured creditor would consent (see art. 66, para. 2). To avoid abuses, paragraph 3 provides that the debtor may not waive defences based on fraud committed by the secured creditor or the debtor's incapacity.

Article 66. Modification of the contract giving rise to a receivable

38. Article 66 is based on recommendation 122 of the Secured Transactions Guide (see chap. VII, paras. 23 and 24), which in turn is based on article 20 of the Assignment Convention. It addresses the impact of an agreement between the grantor of a security right in a receivable and the debtor of the receivable that modifies the terms of the receivable. The result depends on when the agreement is made. Under paragraph 1, if the agreement is concluded before the debtor receives notification of a security right in the receivable, it is effective against the secured creditor, but the secured creditor also enjoys any benefits derived from the agreement.

39. Under paragraph 2, even if the agreement is concluded after notification, it is also effective, even if it affects the secured creditor's rights provided that: (a) the secured creditor consents to it; or (b) the receivable has not been fully earned by performance and the modification was provided for in the contract giving rise to the receivable or a reasonable secured creditor would consent to the modification. Paragraph 3 provides that paragraphs 1 and 2 do not affect any right of the grantor or secured creditor arising under other law for breach of an agreement between them (such as an agreement that the grantor would not agree to any modifications of the terms of the receivable).

Article 67. Recovery of payments

40. Article 67 is based on recommendation 123 of the Secured Transactions Guide (see chap. VII, paras. 25 and 26), which in turn is based on article 21 of the Assignment Convention. It addresses the situation in which the grantor of a security right in a receivable (or the transferor in an outright transfer of the receivable by agreement) fails to perform its obligations under the contract giving rise to the receivable. The article insulates the secured creditor from liability in this circumstance, by providing that the debtor of the receivable may not look to the secured creditor to recover any amount that it has paid to either the grantor or the secured creditor. As a result, the debtor of the receivable bears the risk of the insolvency of the other party to the contract giving rise to the receivable (i.e. the grantor).

B. Negotiable instruments

Article 68. Rights as against the obligor under a negotiable instrument

41. Article 68 is based on recommendation 124 of the Secured Transactions Guide (see chap. VII, paras. 27-31). It is intended to preserve the rights of parties under the relevant law relating to negotiable instruments (to be specified by the enacting State). For example, under that law: (a) a secured creditor with a security right in a negotiable instrument may collect from the obligor under the instrument only in accordance with its terms; (b) even if the grantor defaults, the secured creditor may collect from the obligor only when payment becomes due under the instrument and the law relating to such instruments; (c) a secured creditor with a security right in a negotiable instrument may have greater rights against the issuer of the instrument than the payee, since the issuer may not be able to raise against the secured creditor defences based on the contract between the issuer and the payee of the instrument. It should be noted that the reference in article 68 (as well as arts. 70 and 71) to another law of the enacting State will only apply if the enacting State's law is the applicable law under the conflict-of-laws rules of chapter VIII.

C. Rights to payment of funds credited to a bank account

Article 69. Rights as against the deposit-taking institution

42. Article 69 is based on recommendations 125 and 126 of the Secured Transactions Guide (see chap. VII, paras. 32-37). It addresses the situation in which a security right is created in a right to payment of funds credited to a bank account.

43. Paragraph 1 (a) provides that the rights and obligations of the deposit-taking institution are unaffected by the security right, unless the institution consents. The rationale for protecting deposit-taking institutions in this manner is that imposing duties on an institution or changing the rights and duties of the institution without its consent may subject that institution to risks that it is not in a position to manage appropriately unless it knows in advance what those risks might be and to the risk of

having to violate obligations imposed by regulatory or other law (see Secured Transactions Guide, chap. VII, para. 33).

44. To safeguard the confidentiality of the relationship of a deposit-taking institution and its client that is imposed by regulatory or other law, paragraph 1 (b) also provides that the deposit-taking institution has no obligation to respond to requests for information (e.g. about the balance in the account, whether a control agreement exists or whether the account holder retains the right to dispose of funds credited to its bank account).

45. Finally, paragraph 2 provides that, even where the deposit-taking institution consents to the creation of a security right in a right to payment of funds credited in a bank account held by a grantor with that institution, any right of set-off that the institution may have under regulatory or other law also remains unaffected. The rationale for this rule is the need to avoid any interference with the way deposit-taking institutions manage risks, given the nature of the transaction and the business of their customer.

D. Negotiable documents and tangible assets covered by negotiable documents

Article 70. Rights as against the issuer of a negotiable document

46. Article 70 is based on recommendation 130 of the Secured Transactions Guide (see chap. VII, paras. 43-45). It provides that, when a secured creditor has a security right in a negotiable document, the rights of the secured creditor as against the issuer of the document or any person obligated on the document are determined by the law relating to negotiable documents (to be specified by the enacting State). This means that, for a secured creditor with a security right in the document to enforce it against the assets covered by the document: (a) at the time of enforcement, the assets covered by the document must still be in the possession of the issuer or other obligor under the document; and (b) the issuer or other obligor will have no obligation to deliver the assets to the secured creditor, unless the negotiable document was transferred to the secured creditor in accordance with the law governing negotiable documents (e.g. with any necessary endorsement).

E. Non-intermediated securities

Article 71. Rights as against the issuer of a non-intermediated security

47. As already mentioned, the Secured Transactions Guide does not address security rights in any types of securities (see rec. 4 (c)). Thus, article 71 is a new rule. In line with articles 68-70, it provides that the rights of a secured creditor holding a security right in non-intermediated securities as against the issuer of the securities are determined by other law of the enacting State. For example, registration on the books of a corporation or special enforcement procedures may be required for a security right in the shares of a corporation to be effective against the issuer.

Chapter VII. Enforcement of a security right

A. General rules

Article 72. Post-default rights

48. Article 72 is based on recommendations 133, 139, 141, 143, and 144 of the Secured Transactions Guide (see chap. VIII, paras. 10-12, 15-17, and 34 and 35). Paragraph 1 clarifies that, following the grantor's default, the grantor and the secured creditor may exercise any right they may have under the provisions of chapter VII, other law or the security agreement (provided that, in the last two cases, that right is not inconsistent with the provisions of the Model Law).

49. For the purposes of the Model Law, "default" includes both events described in the relevant law as a "default" and events agreed to by the parties as a "default" (see art. 2, subpara. (j)). It should also be noted that some of the rights under this article may be available even before default. Thus, for example, even before default: (a) the grantor may exercise its right of redemption where permitted under contract law; (b) with the agreement of the grantor, the secured creditor may collect a receivable (see art. 82, para. 2); and (c) any party may apply to a court or other authority for relief under general procedural or other law (see also art. 74).

50. Paragraph 2 indicates that the exercise of one right generally does not prevent the exercise of another right, except if the exercise of one right makes impossible the exercise of another right (e.g. if the secured creditor decides to obtain possession and sell the encumbered asset, and sells or enters into an agreement to sell the asset, it cannot propose to acquire it in satisfaction of the secured obligation).

51. Paragraph 3 provides that the debtor (generally defined to include the grantor and any other person that owes payment or other performance of a secured obligation but not a transferor in an outright transfer of a receivable (see arts. 1, para. 2, and 2, subpara. (h)) may not waive unilaterally or vary by agreement their rights under this chapter before default. Otherwise, the secured creditor could put pressure on the debtor to waive or vary its rights before default in return for concessions in the security agreement (see Secured Transactions Guide, chap. VIII, paras. 16 and 17).

Article 73. Methods of exercising post-default rights

52. Article 73 is based on recommendation 142 of the Secured Transactions Guide (see chap. VIII, paras. 18-20 and 29-33). Paragraph 1 clarifies that the secured creditor may exercise its post-default rights by applying to a court or other authority to be specified by the enacting State (e.g. a chamber of commerce, arbitral tribunal or notary public). There are many reasons why a secured creditor may decide to follow this approach. For example, judicial or similar proceedings may be sufficiently efficient, the secured creditor may wish to avoid having its self-help actions subsequently challenged, anticipate that it will have to apply to a court or other authority anyway to recover an anticipated deficiency or may fear and

wish to avoid a breach of public order (see Secured Transactions Guide, chap. VIII, paras. 32 and 33).

53. Where judicial or other similar proceedings are likely to be slow and costly, and less likely to produce the highest possible amount upon the disposition of the encumbered assets, the secured creditor may decide to enforce its security right with minimal or no supervision by a court or other authority (see Secured Transactions Guide, chap. VIII, paras. 29 and 31). In such a case, the Model Law introduces a number of safeguards for the grantor, the debtor and other persons the rights of whom may be affected. For example, under article 4, the secured creditor has to proceed in good faith and in a commercially reasonable manner and, under article 77, paragraph 2, ensure that the grantor has consented in writing, the grantor and any person in possession have been notified of the secured creditor's intent and at the time of repossession the person in possession does not object (see para. 67 below).

54. In any case, the Model Law does not introduce any limitation to the ability of the parties to avail themselves of the assistance of a court or other authority at any time to resolve a dispute arising in relation to a security agreement or the exercise of a post-default right. Quite to the contrary, under article 74, the grantor, any person with a right in the encumbered asset or the debtor (option A), or any person affected by the non-compliance of the secured creditor with the provisions of this chapter (option B) is entitled to relief from a court or other authority.

55. It should also be noted that there is nothing in the Model Law that precludes the grantor and the secured creditor from agreeing to resolve any dispute that may arise between them by arbitration, conciliation or negotiation. Depending on the efficiency of court proceedings in a particular State, these alternative dispute resolution mechanisms may provide a viable alternative to court proceedings, provided that certain issues are addressed by the relevant law, in particular with respect to arbitration, such as the arbitrability of disputes arising under a security agreement or associated with a security right, protection of rights of third parties and the confidentiality of arbitral proceedings (see also para. 58 below).

56. Under paragraph 2, the exercise of post-default rights by application to a court or other authority is subject not only to the provisions of this chapter but also to the relevant provisions, including provisions on expeditious proceedings, to be specified by the enacting State (typically, procedural in nature). Under paragraph 3, the exercise of those rights without application to a court or other authority is subject only to the provisions of this chapter.

Article 74. Relief for non-compliance

57. Article 74, which is based on recommendation 137 of the Secured Transactions Guide (see chap. VII, para. 31), addresses the availability of relief by a court or other authority in the case of a person's non-compliance with its obligations under the provisions of this chapter. Two options are provided for the enacting State to choose the option that best fits its legal system. The first option addresses non-compliance only by the secured creditor, and provides that the grantor, any other person with a right in the encumbered asset or the debtor affected by that non-compliance (e.g. co-owners of the encumbered assets) may seek relief. The second option is broader, addressing non-compliance by any person, and giving any

person affected by that non-compliance the right to seek relief. It should be noted that: (a) a violation of the secured creditor's obligations includes a violation by the secured creditor's agents, employees or service providers; and (b) persons that may be affected include a secured creditor with a lower priority ranking than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered assets.

58. The enacting State may wish to specify the court or other authority to which the party seeking relief should apply and the type of expeditious proceeding that would be available. That authority may include an arbitral tribunal, chamber of commerce or notary public. The resolution of a dispute arising generally from a security agreement or specifically in the context of enforcement of a security right by arbitration would be possible if: (a) the matter may be submitted to arbitration under the law of the enacting State; and (b) there is an arbitration agreement between the grantor and the secured creditor that is enforceable under the law of the enacting State. In such a case: (a) the arbitration agreement (and arbitral award) would bind only the parties thereto; and (b) if the winning party attempts to seize an encumbered asset, the law of the enacting State must provide adequate protection for the rights of persons, who are not party to the arbitration agreement, in the encumbered assets. For example, persons who are not parties to the arbitration agreement who have a right in the encumbered assets or might be affected by the enforcement of an arbitral award should be notified before an extrajudicial sale takes place (see art. 78, para. 4) and be given an opportunity to assert their rights, such as their right to take over enforcement (see art. 76), or their right to be paid from the proceeds of a sale according to their priority rank (see art. 79, para. 2).

59. As the length of time that it takes to obtain relief for non-compliance may bring about injustice or inefficiency, this article provides for the possibility of expeditious relief, the exact form of which is to be specified by the enacting State (e.g. proceedings for interim measures of protection and preliminary orders). [Explain the word "affected". See Commission report, para. 72.]

Article 75. Right of affected persons to terminate enforcement

60. Article 75 is based on recommendation 140 of the Secured Transactions Guide (see chap. VIII, paras. 22-24). Paragraph 1 enables any person whose rights in the encumbered assets are affected by the enforcement process to terminate it by paying or otherwise performing the secured obligation in full. This is sometimes known as "redeeming" the encumbered asset. A person that is affected by the enforcement of a security right is most likely to exercise this right when there will be a residual value because the value of the asset is higher than the outstanding part of the secured obligation. It should be noted that the extinguishment of a security right, which was also addressed in recommendation 140 of the Secured Transactions Guide, is addressed in article 12.

61. Full payment, for the purposes of paragraph 1, includes the reasonable cost of enforcement. Thus, in the case of enforcement before a court or other authority, the court or other authority will determine the reasonable cost of enforcement. In the case of enforcement without an application to a court or other authority, if the grantor or other interested person disputes the secured creditor's assertion as to the reasonable cost of enforcement, the grantor or other interested person could seek the assistance of a court or other authority to resolve the dispute.

62. Under paragraph 2, the right to terminate enforcement may be exercised until the secured creditor has disposed of, acquired or collected the encumbered asset, or entered into an agreement for that purpose. Otherwise, the finality of acquired rights would be undermined (see paras. 79-81). Under paragraph 3, the rule in paragraph 2 does not apply in the case of a lease or licence of an encumbered asset. This means that a person affected by the enforcement may still terminate the enforcement process, if there is sufficient residual value left in the encumbered asset. However, there is one limitation, the rights of a lessee or licensee must be respected.

Article 76. Right of a higher-ranking secured creditor to take over enforcement

63. Article 76 is based on recommendation 145 of the Secured Transactions Guide (see chap VIII, para. 36). Paragraph 1 provides that a secured creditor whose security right has priority over that of the enforcing secured creditor or judgment creditor ("higher-ranking secured creditor") has the right to take over enforcement. Inasmuch as the higher-ranking secured creditor is entitled to be paid out of the proceeds of any disposition before the other secured creditor or judgment creditor, paragraph 1 recognizes that this greater stake in the results of enforcement justifies giving the higher-ranking secured creditor the right to control the enforcement process if it so desires. The higher-ranking secured creditor may take over the enforcement process at any time before the asset is sold or otherwise disposed of, or acquired by the secured creditor or until the conclusion of an agreement by the secured creditor for that purpose.

64. Under paragraph 2, the right of the higher-ranking secured creditor to take over the enforcement process includes the right to enforce by any of the methods foreseen in this chapter. This means that the higher-ranking secured creditor may change the method of enforcement, for example to follow a different strategy than that followed by the original enforcing creditor (or terminate enforcement if the higher-ranking secured creditor is an outright transferee). It should be noted, however, that the exercise of this right is subject to the standard of article 4, that is, the secured creditor would be obliged to act in good faith and in a commercially reasonable manner, for example, to avoid unreasonable enforcement costs.

Article 77. Right of the secured creditor to obtain possession of an encumbered asset

65. Article 77 is based on recommendations 146 and 147 of the Secured Transactions Guide (see chap. VIII, paras. 37-48 and 51-56). Taken as a whole, this article provides a secured creditor with an important pair of options about enforcing its security right. The secured creditor may obtain possession of a tangible encumbered asset either through a judicial process or an analogous process with another authority or, in certain circumstances, the secured creditor can utilize "self-help remedies" and obtain possession of the encumbered asset without resort to a court or other authority. The rules governing each of these options are set out separately, with paragraphs 1 and 2 setting the parameters for obtaining possession by application to a court or other authority and paragraph 3 setting the parameters for the exercise of a self-help remedy by the secured creditor.

66. Paragraph 1 states that, after default, the secured creditor is entitled to obtain possession of an encumbered asset by applying to a court or other authority, or

without such an application. The opening words of paragraph 1 however, subordinate this right to the right of another person who has a superior right to possession of the asset (e.g. a lessee or licensee; see art. 34).

67. Under paragraph 2, the secured creditor is also entitled to obtain possession of an encumbered asset without applying to a court or other authority if all the conditions set out therein are met. The conditions are designed to ensure that such a self-help remedy is available only in appropriate circumstances. First, the self-help remedy is available only if the grantor has consented in writing to the secured creditor obtaining possession without resort to a court or other authority. Typically, the secured creditor will obtain the grantor's consent in the security agreement. Second, the secured creditor cannot utilize this self-help remedy unless it has given the grantor and any person in possession of the encumbered asset notice of default and of the secured creditor's intent to obtain possession without resort to a court or other authority (the enacting State may wish to specify how long before seeking possession the secured creditor must give notice that would be in line with the good faith and commercial reasonableness standard set forth in art. 4). Third, and perhaps most important, the secured creditor may not obtain possession without resorting to a court or other authority if the person in possession of the encumbered asset objects to the secured creditor's attempt to utilize this self-help remedy. Thus, the grantor or other person in possession of the encumbered asset will always have the ability to require the secured creditor to utilize the judicial or similar process by objecting to the creditor's attempt to act without the assistance of a court or other authority, even if the grantor has already agreed to the secured creditor's self-help remedies in the security agreement.

68. Paragraph 3 recognizes that even relatively short delays associated with giving the notice required in paragraph 2 can be economically wasteful if the encumbered assets are perishable or otherwise likely to decline speedily in value. Accordingly, paragraph 3 dispenses with the requirement of notice in those cases.

69. Under paragraph 4, a lower-ranking secured creditor may not obtain possession of an encumbered asset from a higher-ranking secured creditor. The purpose of this provision is to ensure that: (a) the security right of the higher-ranking secured creditor does not cease to be effective against third parties through the relinquishment of possession to the lower-ranking secured creditor and thus lose its priority status; (b) the value of the encumbered asset does not diminish through its disposition by the lower-ranking secured creditor. It should be noted, however, that the lower-ranking secured creditor will be able to enforce its security right without obtaining possession and the buyer of the encumbered asset would acquire its rights in the asset subject to the right of the higher-ranking secured creditor (see art. 81).

Article 78. Right of the secured creditor to dispose of an encumbered asset

70. Article 78 is based on recommendations 148-151 of the Secured Transactions Guide (see chap. VIII, paras. 48 and 57-60). Paragraph 1 provides that the secured creditor may sell or otherwise dispose of, lease, or license an encumbered asset by applying to a court or other authority (to be specified by the enacting State) or may take those actions without making such an application. Paragraph 2 provides that, if the secured creditor decides to exercise its right by applying to a court or other

authority, the enacting State may specify the rules that will determine the method, manner, time, place and other aspects of the sale or other disposition, lease or licence.

71. Paragraphs 3-8 deal with dispositions by the secured creditor without an application to a court or other authority. Under paragraph 3, the secured creditor may determine the aspects of the sale or other disposition, lease or licence (including whether to sell or otherwise dispose, lease or license encumbered assets individually, in groups or altogether). Under paragraph 4, the secured creditor must give to the grantor, the debtor, any person with a right in the encumbered asset that notifies in writing the secured creditor of those rights and any other secured creditor that registered a notice in the Registry or was in possession of the encumbered asset a notice that contains all the elements set out in paragraphs 5-7. The enacting State should specify a very short period of time within which the secured creditor must give the notice. Under paragraph 8, the notice need not be given if the encumbered asset is perishable, may decline in value speedily or is of a kind sold on a recognized market. "Recognized market" in this context means a market in which prices were set by the market and not by individual sellers. It should be noted this rule does not mean that a notice was not required for an out-of-court sale of a controlling stake in a company.

72. Subject to its obligation to act in good faith and in a commercially reasonable manner (see art. 4), the secured creditor may: (a) dispose of the encumbered assets by public or private sale, and if by public sale, through auction or tender; and (b) decide whether to dispose of the encumbered assets individually, in groups or as a whole (see art. 78, para. 3, and Secured Transactions Guide, chap. VIII, paras. 71-73).

Article 79. Distribution of the proceeds of a disposition of an encumbered asset and debtor's liability for any deficiency

73. Article 79 is based on recommendations 152-155 of the Secured Transactions Guide (see chap. VIII, paras. 60-64). Paragraph 1 provides that, in the case of a sale or other disposition, lease or licence supervised by a court or other authority, the distribution of the proceeds is determined by the rules to be specified by the enacting State. However, such distribution should follow the order of priority according to the priority rules of the Model Law.

74. Under paragraph 2, the distribution of the proceeds of a sale or other disposition, lease or licence that occurs without an application to a court or other authority must follow the rules set forth in paragraph 2 that determine the order in which the proceeds are to be applied. Paragraph 2 (b) requires payment to a subordinate competing claimant. This is so because, under article 81, paragraphs 3 and 4, the security right of a higher-ranking secured creditor is preserved even after enforcement by a lower-ranking secured creditor.

75. Under paragraph 3, if the net proceeds of disposition are insufficient to satisfy the secured obligation, leaving a shortfall, the debtor remains obligated to pay the remainder. It should be noted that damages for non-compliance with enforcement obligations are a matter for other law, in particular in relation to consumer transactions. Thus, if a sale of an encumbered asset is not commercially reasonable and the debtor has a counter-claim, the debtor may be liable only for a

reduced shortfall. It should also be noted that this article, as well as articles 72, paragraph 1-3, to 81, does not apply to outright transfers of receivables (see art. 1, para. 2). It should be noted that: (a) the distribution of proceeds would require that the secured creditor report and provide an account to the grantor, the debtor and any subordinate competing claimant; and (b) any amount owing to the secured creditor after application of the net proceeds to the secured obligation would be an amount owing after deduction of any amount owing to the grantor by the secured creditor.

Article 80. Right to propose the acquisition of an encumbered asset by the secured creditor

76. Article 78 is based on recommendations 156-159 of the Secured Transactions Guide (see chap. VIII, paras. 65-70). Paragraph 1 states the right of the secured creditor to propose in writing to acquire one or more of the encumbered assets in total or partial satisfaction of the secured obligation. Paragraph 2 indicates to whom other than the grantor the proposal must be sent. Paragraph 3 governs the content of the proposal.

77. Paragraphs 4 and 5 provide rules that determine the outcome of the secured creditor's proposal. Paragraph 4 provides that, in the case of a proposal for the acquisition of an encumbered asset in full satisfaction of the secured obligation, the secured creditor acquires the encumbered asset in accordance with the proposal so long as none of the persons to whom the proposal must be sent objects within a short period of time after the proposal is received by those persons (to be specified by the enacting State); if any of those parties object, however, the secured creditor may not proceed. Paragraph 5 provides that, in the case of a proposal for the acquisition of the encumbered asset in partial satisfaction of the secured obligation, the secured creditor acquires the encumbered asset only if all of the addressees consent within a short period of time after the proposal is received by those persons (to be specified by the enacting State). This approach is intended to safeguard the rights of all addressees of the notice, since they will remain liable for part of the secured obligation or they may otherwise be affected by the enforcement of a security right.

78. Paragraph 6 provides a mechanism whereby the grantor can initiate this process rather than the secured creditor, by requesting a proposal from the secured creditor. If the secured creditor makes a proposal in response to the grantor's request, and the secured creditor accepts it, the secured creditor must proceed as provided in paragraphs 2-5.

Article 81. Rights acquired in an encumbered asset

79. Article 81 is based on recommendations 160-163 of the Secured Transactions Guide (see chap. VIII, paras. 74-81). It is intended to deal with the finality of rights acquired in an encumbered asset pursuant to the enforcement of a security right (e.g. whether a transferee acquires its rights free or subject to the security right). Paragraph 1 deals with sales or other dispositions under the supervision of a court or other authority and refers the finality of rights to the law to be specified by the enacting State. Paragraph 2 deals with leases and licences of encumbered assets under the supervision of a court or other authority and provides that the enacting State should specify whether the lessee or licensee acquires its rights to use the leased or licensed encumbered asset unaffected by the security right.

80. Under paragraphs 3 and 4, in the case of a sale or other disposition, lease or licence of an encumbered asset without application to a court or other authority, the buyer or other transferee acquires its rights subject only to rights that have priority over the security right of the secured creditor, and the lessee or licensee is entitled to the benefit of the lease or licence except as against creditors with rights that have priority over the rights of the secured creditor.

81. Under paragraph 5, if the sale or other disposition, lease or licence of an encumbered asset takes place in violation of the provisions of chapter VII, the buyer or other transferee, lessee or licensee does not acquire any rights or benefits[, if it had knowledge of the violation and that the violation materially prejudiced the rights of the grantor or another person].

B. Asset-specific rules

Article 82. Collection of payment

82. Article 82 is based on recommendations 169-171, 173 and 175 of the Secured Transactions Guide (see chap. VIII, paras. 93-98, 102-108, 111 and 112). Under paragraph 1, where the encumbered asset is a right to receive payment, the secured creditor is entitled to collect payment from the obligor after default (without having to sell or otherwise dispose that right). Under paragraph 2, with the agreement of the grantor, the secured creditor may also exercise the right to collect before default. Under paragraph 3, a secured creditor that collects under paragraph 1 or 2 also has the benefit of any personal or property right that secures or supports payment of the encumbered asset.

83. Under paragraph 4, notwithstanding the general rule of this article, a deposit-taking institution need not pay a secured creditor with a security right in a right to payment of funds credited to a bank account held with that deposit-taking institution against its consent without a decision by a court or other authority. However, the secured creditor may collect the balance credited in a bank account without applying to a court or other authority if the security right in the right to payment of the funds has been made effective against third parties by the security right being created in favour of the deposit-taking institution, the conclusion of a control agreement or the secured creditor becoming the account holder (see art. 25).

Article 83. Collection of payment by an outright transferee of a receivable

84. Article 83 is based on recommendations 167-168 of the Secured Transactions Guide (see chap. VIII, paras. 99-101). It provides that, in the case of an outright transfer of a receivable, the transferee is entitled to collect the receivable either before or after default, provided that payment is due. It should be noted that the standards of good faith and commercial reasonableness do not apply to an outright transfer of a receivable without recourse to the transferor, as the grantor (transferor) has no remaining vested interest in the receivable that could be protected by a limitation on the way in which the secured creditor (transferee) could collect the receivable.