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Security Interests

Recommendations of the draft Legislative Guide on Secured Transactions

Report of the Secretary-General

Addendum

Contents

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VII. Pre-default rights and obligations of the parties

Purpose

The purpose of the provisions of the law on pre-default rights and obligations of the parties is to:

(a) Provide rules on additional terms for a security agreement with a view to rendering secured transactions more efficient and predictable;

(b) Reduce transaction costs by eliminating the need to negotiate and draft terms to be included in the security agreement where the rules provide an acceptable basis for agreement;

(c) Reduce potential disputes;

(d) Provide a drafting aid or checklist of issues the parties may wish to address at the time of negotiation and conclusion of the security agreement; and

(e) Encourage party autonomy.

Party autonomy

86.

Alternative A

The law should allow the parties to waive or vary their rights and obligations unless such waiver or variation is against public policy or fails to adequately protect third parties.

Alternative B

The law should provide that, except as otherwise provided in [specify the provisions that may not be derogated from or varied by agreement], the secured creditor and the grantor may derogate from or vary by agreement its provisions relating to their respective rights and obligations. Such an agreement should not affect the rights of any person who is not a party to the agreement.

[*Note to the Working Group: The Working Group may wish to consider the formulation of the recommendation on party autonomy and whether it should be placed in this Chapter or in the Chapter on scope and general provisions. The Working Group may also wish to consider together with this recommendation the recommendations on party autonomy in Chapter VIII.*]

Suppletive rules

87. The law should include suppletive, non-mandatory rules that would apply in the absence of contrary agreement of the parties. Such rules should, inter alia:

(a) Provide for the care of the encumbered assets by either the grantor or the secured creditor in possession of the encumbered assets;

(b) Preserve the security rights in the encumbered assets, including the right to proceeds or civil fruits derived from the encumbered assets;

(c) Provide for the right of the grantor to continue the operation of its business including the right to use, commingle and dispose of the encumbered assets in the ordinary course of its business; and

(d) Secure the discharge of a security right once the obligation it secures has been paid or otherwise performed.

VIII. Default and enforcement

Purpose

The purpose of the provisions of the law on default and enforcement is to:

(a) Provide clear and simple procedures for the enforcement of security rights after debtor default in a predictable and efficient manner;

(b) Provide procedures that maximize the potential realization value of the encumbered assets for the grantor, the secured creditor and other creditors of the grantor;

(c) Provide for expeditious judicial and, subject to appropriate safeguards, non-judicial methods for the secured creditor to realize the value of the encumbered assets ;

(d) Coordinate the secured transactions enforcement regime with other law governing the enforcement of claims in encumbered assets, including insolvency law.

Scope

88. The law should provide that this Chapter does not apply to an absolute transfer of receivables, except to the extent that there is recourse to the transferor for a payment default of the account debtor.

[*Note to the Working Group: Recommendation 88 is intended to clarify that this Chapter applies only to assignments that serve security purposes.*]

General standard of conduct

89. The law should provide that all parties must enforce their rights and perform their obligations under the rules recommended of this Chapter in good faith and in a commercially reasonable manner. Any party that fails to comply with the rules of this Chapter is liable for any loss caused by that failure.

[*Note to Working Group: The Working Group may wish to consider whether the principle in recommendation 89 should be applied, as appropriate, in the exercise of rights and performance of duties under all Chapters of the Guide.*]

Party autonomy

90. The law should provide that the general standard of conduct set forth in recommendation 89 cannot be waived or varied. No other rule recommended in this Chapter that gives rights to the grantor or to any other person or imposes obligations

on the secured creditor may be waived or varied by agreement prior to the debtor's default.

91. Subject to recommendations 89 and 90, the law should permit parties to the security agreement or any other person to waive or vary by agreement rules recommended of this Chapter after the debtor's default. Such an agreement does not affect the rights of a person not party to the agreement. The person challenging such an agreement has the burden of showing that the agreement was made prior to default or was inconsistent with recommendations 89 or 90.

[*Note to the Working Group: The words "subject to ..." are intended to clarify that the general standard of conduct provided in recommendation 89 is applicable and cannot be waived or varied. No reference is made to public policy as the standard set forth in recommendation 89 will reflect the public policy of the State enacting these recommendations. The Working Group may also wish to consider including the following additional text in recommendation 91: "The law should provide that a disposition of encumbered assets in accordance with a method provided in the security agreement is commercially reasonable unless the objecting party establishes that it was manifestly unreasonable." Such an agreement can take place before or after default and its objective would be to indicate how a secured creditor is to meet the obligation to dispose of an encumbered asset in a commercially reasonable way.*]

Rights and remedies after default

92. The law should provide that after default the grantor and the secured creditor have the rights and remedies provided in the rules recommended in this Chapter, in the security agreement (except to the extent inconsistent with the rules recommended in this Chapter) and in any other law.

Secured creditor remedies

93. The law should provide that after default the secured creditor may exercise one or more of the following remedies:

(a) Obtain possession of tangible encumbered assets;

(b) Collect on encumbered assets that are receivables, negotiable instruments, bank accounts or proceeds from drawings under independent undertakings;

(c) Enforce rights under negotiable documents;

(d) Sell, lease, license, or otherwise dispose of encumbered assets;

(e) Propose to the grantor that the secured creditor accept the encumbered assets in total or partial satisfaction of the secured obligations; and

(f) Any other remedy provided in the security agreement (except to the extent inconsistent with the rules recommended in this Chapter) or any other law.

Grantor remedies

94. The law should provide that after default the grantor may exercise one or more of the following remedies:

(a) At any time after default and until the disposition, acceptance or collection of the encumbered assets by the secured creditor, pay in full the secured obligation, including interests and costs of enforcement up to the time of full payment, and obtain a release of the encumbered assets from the security right;

(b) Apply to a court or other authority for relief if the secured creditor has not complied or is not complying with its obligations under the rules recommended in this Chapter with respect to extrajudicial enforcement;

(c) Reject the proposal of the secured creditor to obtain the encumbered assets in total or partial satisfaction of the secured obligations within the time limits prescribed by the rules recommended in this Chapter; and

(d) Any other remedy provided in the security agreement (except to the extent prohibited by the rules recommended in this Chapter) or any other law.

Election of remedies

95. The law should provide that the exercise of a remedy does not prevent the exercise of another remedy.

[*Note to Working Group: This recommendation relates to both the situation where exercise of one or more remedies has not resulted in the complete satisfaction of the secured obligation and the situation where a creditor or grantor has commenced the exercise of a remedy and later commences the exercise of a different remedy. For example, a creditor has given the notice for an auction and later chooses instead to pursue a judicial remedy.*]

Other remedies

96. The law should provide that the exercise of remedies with respect to the encumbered assets under this law does not prevent any party from exercising its remedies with respect to the secured obligation.

Release of the encumbered assets after full payment

97. The law should provide that, after default and until a disposition, acceptance or collection of the encumbered assets by the secured creditor, the debtor, the grantor or any other interested party (e.g. 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) is entitled to pay in full the secured obligation, including interest and the costs of enforcement up to the time of full payment. The law should specify that the effect of such payment is to release the encumbered assets from the security right, or, to the extent provided in other law, to subrogate any other interested party that makes the payment to the rights of the secured creditor.

Judicial and extrajudicial enforcement

98. The law should enable the secured creditor after default to:

(a) Resort to court or other authority to enforce its security right; or

(b) Enforce its security right without resorting to court or other authority.

[Notice of intention to pursue extrajudicial enforcement

99. The law should:

(a) Address whether, when and to whom a secured creditor is required to give notice of its intention to pursue extrajudicial enforcement of a security right following default;

(b) State the manner in which the notice is to be given, its timing, and its minimum contents, including whether the notice [to the grantor] should contain an accounting of the amount then owed and a description of the steps the debtor or the grantor must take to obtain the release of the encumbered assets from the security right under recommendation 97;

(c) Provide that the notice should be in a language that is reasonably expected to inform its recipients about its contents, such as the language of the security agreement;

(d) Address whether the notice must be registered in the security rights registry;

(e) Address the legal consequences of insufficient or erroneous notices of intention to pursue extrajudicial enforcement; and

(f) List circumstances in which the notice need not be given in order to avoid a negative effect on the realization value of the encumbered assets (e.g. perishable tangibles).]

[*Note to the Working Group: The Working Group may wish to consider recommendation 99 together with recommendations 111 and 112. The Working Group may also wish to consider whether, while recommendation 99 may be appropriate in the case of consumer grantors or security rights in immovable property, it might inadvertently give a business grantor the opportunity to move movable encumbered assets beyond the reach of the secured creditor and thus frustrate the purpose of the security right. If the Working Group finds that assumption to be correct, it may wish to replace recommendation 99 by text addressing notices to consumer grantors or leave the matter to consumer-protection law.*]

Objections to extrajudicial enforcement

100. The law should provide that nothing in the law prevents the debtor, the grantor or other interested parties (e.g. 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) from applying to a court or other authority for relief if the secured creditor has not complied or is not complying with its obligations under the rules recommended in this Chapter. The law should build safeguards into the process to discourage unfounded applications and to prevent any improper interference with or undue delay of the secured creditor's ability to realize on encumbered assets.

Dispossession of the debtor

101. The law should provide that after default the secured creditor is entitled to obtain possession of the encumbered assets either without resorting to a court or other authority, or with the assistance of a court or other authority. In either case, the

law should provide an expedited process enabling a secured creditor to obtain, upon ex parte application, a court order obliging the grantor either to permit the secured party to take possession of the encumbered assets or to keep the encumbered assets in their present location and condition until further court order, and to permit service of the order on the grantor concurrently with or prior to the giving of notice of the application and any other notice required under the rules recommended in this Chapter.

[*Note to the Working Group: Any person entitled to seek relief under recommendation 100 may do so.*]

Collection of receivables

102. The law should provide that after default the secured creditor may instruct any account debtor on a receivable that is an encumbered asset to pay the receivable directly to the secured creditor or, if otherwise instructed in the notification of the assignment by the secured creditor in a writing received by the account debtor, in accordance with such payment instruction (for the rights of account debtors, see recommendations 17-23 in A/CN.9/WG.VI/WP.21).

[*Note to the Working Group: Recommendation 102 tracks the language of article 17 (2) of the United Nations Assignment Convention.*]

103. The law should provide that the secured creditor's right to collect a receivable includes the right to enforce any right supporting payment or performance of the receivable, such as a guarantee or security right.

Negotiable instruments

104. The law should provide that after default the secured creditor has the right to enforce a negotiable instrument against a person obligated on that instrument. However, as between the secured creditor and the person obligated on the negotiable instrument or other persons claiming rights under the law governing negotiable instruments, the obligations and rights of those persons are determined by the law governing negotiable instruments.

[*Note to Working Group: The commentary will include the following examples of such persons:*

(a) The person obligated on the negotiable instrument may be obligated to pay only a holder or other person entitled to enforce the instrument under the law governing negotiable instruments; and

(b) The right of the person obligated on the instrument to raise defences to that obligation is determined by the law governing negotiable instruments.]

105. The law should provide that the secured creditor's right to enforce a negotiable instrument includes the right to enforce any right supporting payment or performance of the negotiable instrument, such as a guarantee or security right.

Proceeds from drawings under independent undertakings

106. The law should provide that a secured creditor's post-default enforcement rights in the proceeds from a drawing under an independent undertaking are subject to the rights, under the law and practice governing independent undertakings, of the

issuer/guarantor or nominated person and of any other beneficiary named in the undertaking or to whom a transfer of drawing rights has been effected. Neither an issuer/guarantor nor a nominated bank is obligated to pay any person other than the named beneficiary, an acknowledged transferee beneficiary, a nominated bank, or an acknowledged assignee of proceeds. The law should provide that a secured creditor that is an acknowledged assignee of the proceeds from a drawing under an independent undertaking has the right to enforce the acknowledgement against an issuer/guarantor or nominated person that withholds assigned proceeds contrary to its acknowledgement.

[*Note to the Working Group: To emphasize that this is a type of original encumbered assets and not proceeds from a different type of encumbered assets, the Working Group may wish to consider replacing the words "proceeds from the drawing from an independent undertaking" with words along the lines "the beneficiary's right to payment resulting from a drawing under an independent undertaking"*.]

Bank accounts

107. The law should provide that after default a secured creditor who has control of a bank account (see recommendation 50 in A/CN.9/WG.VI/WP.21/Add.1) is entitled to enforce its security right in accordance with the terms of the agreement with the bank establishing control without having to resort to a court or other authority. However, with respect to a bank account where the grantor is an individual and the obligation secured by the security right in the bank account was incurred for the grantor's personal, family or household purposes, the secured creditor may enforce its security right only by resorting to a court or other authority, whether or not it has control of the bank account.

108. The law should provide that a secured creditor who does not have control of a bank account is entitled to enforce the security right only pursuant to a court order.

Negotiable documents

109. The law should provide that after default the secured creditor has the right to enforce a negotiable document against the issuer. However, as between the secured creditor and the issuer, the obligation of the issuer is determined by the law governing negotiable documents.

[*Note to Working Group: The commentary will include the example that the issuer may be obligated to deliver the goods only to a holder of the negotiable document with respect to them.*]

Disposition of encumbered assets

110. The law should provide that a secured creditor after default is entitled to sell, lease, license or otherwise dispose of encumbered assets:

(a) By resort to court or other authority; or

(b) Without resorting to court or other authority.

Advance notice with respect to extrajudicial disposition of encumbered assets

111. The law should:

(a) Address whether, when and to whom a secured creditor is required to give notice with respect to extrajudicial disposition of an encumbered asset after default;

(b) State the manner in which any such notice is to be given, its timing, and its minimum contents, including whether the notice [to the grantor] should contain an accounting of the amount then owed and the right of the debtor or the grantor to obtain the release of the encumbered assets from the security right under recommendation 97;

(c) Provide that any such notice should be in a language that is reasonably expected to inform its recipients about its contents (it is sufficient if the notice is in the language of the security agreement);

(d) Address the legal consequences of insufficient or erroneous notices of with respect to extrajudicial dispositions; and

(e) List circumstances in which any such notice need not be given in order to avoid a negative effect on the realization value of the encumbered assets (e.g. perishable tangibles).

112. The law should provide rules ensuring that the notice can be given in an efficient, timely and reliable way so as to protect the debtor, the grantor or other interested parties, while, at the same time, avoiding having a negative impact on the secured creditor's remedies and the potential realization value of the encumbered assets.

[*Note to Working Group: As there is a significant amount of overlap between recommendation 111 and recommendation 99 (which may be appropriate only for consumer grantors), the Working Group may wish to consider whether recommendation 99 should be retained. If recommendation 99 is retained, the Working Group may wish to consider whether it should be aligned with recommendations 111 and 112.*]

Acceptance of encumbered assets in satisfaction of the secured obligation

113. The law should provide that after default a secured creditor may propose to accept, without resorting to a court or other authority, one or more of the encumbered assets in total or partial satisfaction of the secured obligation.

114. The law should provide that a secured creditor who proposes to accept an encumbered asset in total or partial satisfaction of the secured obligation must give advance notice of the proposal to:

(a) The grantor, the debtor and any other person who owes payment of the secured obligation (e.g. a guarantor);

(b) Any person with rights in the encumbered asset who, prior to the sending of the notice by the secured creditor, has notified in writing the secured creditor of those rights; and

(c) Any other secured creditor who has registered a notice of a security right in the encumbered asset in the name of the grantor or who was in possession of the encumbered asset at the time it was seized by the secured creditor.

115. The law should provide that, if a person entitled to notice under recommendation 114 objects in writing to a proposal [within a short time period, such as 20 days, of the date notice is given] to accept the encumbered assets in total or partial satisfaction of the secured obligation, the secured creditor may not proceed with the proposal but must dispose of the encumbered assets in accordance with the rules governing dispositions. However, the secured creditor should be entitled to apply to a court or other authority for a determination of the reasonableness of the objection.

Surplus and shortfall

116. The law should provide that the enforcing secured creditor must apply any proceeds of its enforcement (including costs of enforcement) to the secured obligations. Except as provided in recommendation 117, the enforcing secured creditor must pay any surplus remaining after such application to subordinate competing claimants, who, prior to any distribution of the surplus, gave written notice of their claims to any surplus to the enforcing secured creditor. Any balance remaining must be remitted to the grantor.

117. The law should also provide that whether or not there is any dispute as to the entitlement of any claimant or as to the priority of payment, the enforcing secured creditor may pay the surplus to a competent judicial or other authority or to a public deposit fund for distribution in accordance with generally applicable procedural rules.

[*Note to the Working Group: The reference to "a competent judicial or other authority, or to a public deposit fund" in the last sentence tracks the language in the United Nations Assignment Convention, article 17(8).*]

118. The law should provide that distribution of the proceeds realized by a judicial disposition or other officially administered process is to be made in accordance with general rules of the State governing execution proceedings.

119. The law should provide that the grantor and any other person who owes payment of the secured obligation are liable for any shortfall still owing after application of the proceeds of enforcement to the secured obligation.

Right of prior-ranking secured creditor to take over enforcement

120. The law should provide that a prior-ranking secured creditor is entitled to take control of enforcement initiated by a subordinate competing claimant at any time before final disposition, acceptance or collection of the encumbered assets. The right to take control includes the right to choose whether or not any disposition will be administered by a court or other authority.

Title or other right acquired through non-judicial disposition

121. The law should provide that, if a secured creditor elects to dispose of an encumbered asset without resorting to a court or other authority, the person that acquires title or other right in the asset in good faith acquires its right in the asset

subject to prior-ranking rights but takes free of the rights of the grantor, the enforcing secured creditor and any subordinate competing claimant. The same rule applies to the title or other right acquired by a secured creditor who has accepted the encumbered assets in total or partial satisfaction of the secured obligation.

[*Note to the Working Group: Reference is made to "title or other right" since, according to recommendation 110 the secured creditor may "sell, lease, license or otherwise dispose of encumbered assets."*]

Title or other right acquired through judicial disposition

122. The law should provide that, if a secured creditor disposes of the encumbered assets through a judicial or other officially administered process, the title or other right acquired by the transferee should be determined by the general rules of the State governing execution proceedings (for the distribution of the money realized by the disposition, see recommendation 118).

Intersection of movable and immovable secured transactions law

123. The law should provide that:

(a) A security right in fixtures in immovables may be enforced in accordance with either this law or the law governing enforcement of encumbrances on immovable property; and

(b) If a secured obligation is secured by both a security right in a movable and an encumbrance on an immovable, the security right in the movable may be enforced in accordance with this law or the law governing enforcement of encumbrances on immovable property.

Coordination with other law

124. The law should be coordinated with general civil procedure law to provide a right for secured creditors to intervene in court proceedings initiated by other creditors of the grantor so as to protect security rights and to ensure the same priority status of security rights as under the law.