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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. [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: Recommendation 86 will be moved to the general provisions of the draft Guide—see A/CN.9/588, para. 47.*]

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.

Application of this chapter to absolute transfers of receivables

88. The law should provide that this chapter applies to the enforcement of the rights of a transferee of receivables acquired by means of an absolute transfer only to the extent that, pursuant to the terms of the transfer, there is recourse to the transferor for a payment default of the account debtor.

[*Note to the Working Group: The Working Group may wish to note that recommendation 88 is intended to clarify that, although the Guide applies generally to the absolute transfer of receivables, this chapter applies only to absolute transfers of receivables made for security purposes.*]

General standard of conduct

89. The law should provide that all parties must enforce their rights and perform their obligations under the recommendations of this chapter in good faith and in a commercially reasonable manner.

Liability for failure to comply with recommendations of this chapter

89 bis. The law should provide that any party that fails to comply with the recommendations of this chapter is liable for any loss caused by that failure.

[*Note to the Working Group: The Working Group may wish to consider whether the principles in recommendations 89 and 89 bis 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 unilaterally or varied by agreement at any time.

[91.] Subject to recommendation 90, the law should provide that; (i) the grantor and any other person who owes payment or other performance of the secured obligation may waive unilaterally or vary by agreement any of their rights and remedies under the recommendations of this chapter only after default, and (ii) the secured creditor may waive unilaterally or by agreement any of its rights and remedies under the recommendations of this chapter at any time. A variation by agreement does not affect the rights of any person not a party to the agreement. A person challenging an agreement has the burden of showing that it was made prior to default or is inconsistent with recommendation 90.

Rights and remedies after default

92. As more specifically provided in other recommendations of this chapter, the law should provide that after default the grantor and the secured creditor have the rights and remedies provided in the recommendations of this chapter, in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) and in any other law.

Secured creditor remedies

93. As more specifically provided in other recommendations of this chapter, the law should provide that after default the secured creditor may exercise one or more of the following remedies with respect to an encumbered asset:

(a) Obtain possession of a tangible encumbered asset;

(b) Collect on an encumbered asset that is a receivable, negotiable instrument, bank account or right to drawing proceeds from an independent undertaking;

(c) Enforce rights under a negotiable document;

(d) Dispose of an encumbered asset;

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

(f) Any other remedy provided in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) or any other law.

[*Note to the Working Group: The Working Group may wish to note that the rule of interpretation "the use of the singular also includes the plural and vice versa" will be added in the general provisions of the Guide.*]

Judicial and extrajudicial enforcement

94. As more specifically provided in other recommendations of this chapter, the law should enable the secured creditor after default to exercise the remedies described in recommendation 93:

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

(b) Without resorting to a court or other authority.

Grantor remedies

95. As more specifically provided in other recommendations of this chapter, the law should provide that after default the grantor may exercise one or more of the following remedies:

(a) At any time before the disposition, acceptance or collection of an encumbered asset by the secured creditor, pay in full the secured obligation, including interest and costs of enforcement up to the time of full payment, and obtain a release from the security right of all encumbered assets securing that obligation;

(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 recommendations of this chapter with respect to extrajudicial enforcement;

(c) Reject the proposal of the secured creditor to accept an encumbered asset in total or partial satisfaction of the secured obligation within the time limits prescribed by the recommendations of this chapter; and

(d) Any other remedy provided in the security agreement (except to the extent inconsistent with the mandatory recommendations of this chapter) or any other law.

Cumulative remedies

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

Other remedies

97. The law should provide that the exercise of remedies with respect to an encumbered asset under this law does not prevent the secured creditor from exercising its remedies with respect to the obligation secured by that encumbered asset. The law should also provide that the exercise of remedies with respect to a secured obligation does not prevent the secured creditor from exercising its remedies with respect to an encumbered asset that secures that obligation.

Release of the encumbered assets after full payment

98. The law should provide that, after default and until a disposition, acceptance or collection of an encumbered asset by the secured creditor, the debtor, the grantor or any other interested party (e.g. a secured creditor whose security right has lower priority 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 from the security right, all encumbered assets securing that obligation 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.

[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 98;

(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 general security rights registry;

(e) Address the legal consequences of failure to comply with the recommendations governing notices with respect to 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 or other assets whose value may decline speedily).]

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 recommendations of 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.

[*Note to the Working Group: The Working Group may wish to consider whether the principle with respect to the right to apply to court for relief by the debtor, grantor or other interested third parties should generally apply to the exercise of all rights and remedies under the recommendations of this chapter and not only with respect to extrajudicial enforcement.*]

Secured creditor's right to take possession of an encumbered asset

101. The law should provide that after default the secured creditor is entitled to take possession of a tangible encumbered asset. The secured creditor may obtain possession of such asset without resorting to a court or other authority, but only if this can be accomplished without the use of force or the threat of force. [The law should provide expedited procedures for situations in which the secured creditor resorts to court or other authority to obtain possession of an encumbered asset.]

[*Note to the Working Group: The Working Group may wish to consider whether the principle of summary judicial proceedings should be reformulated as a general principle that would apply to the exercise of all rights and remedies under the recommendations of this chapter. If so, language along the following lines could*

be considered: "The law should provide for summary judicial proceedings with respect to the exercise of rights and remedies of the secured creditor, the grantor, and any other person who owes performance of the secured obligation or claims to have a right in the encumbered assets". The commentary will explain that any person entitled to seek relief under recommendation 100 may seek such relief for violation of this recommendation. Also, the terminology section of the Guide will include a definition of "possession" that defines the term to mean actual rather than fictive or constructive possession.]

Collection of receivables

102. With respect to a receivable that is an encumbered asset, the law should provide that after default the secured creditor may collect or otherwise enforce the receivable.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that the secured creditor may, as an alternative, elect to dispose of a receivable pursuant to recommendations 93 (d) and 110.*]

103. The law should provide that the secured creditor's right to collect or otherwise enforce a receivable includes the right to collect or otherwise enforce any personal or property right that supports 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 that is an encumbered asset against a person obligated on that instrument. However, as between the secured creditor and (i) the person obligated on the negotiable instrument, or (ii) 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 collect or enforce a negotiable instrument includes the right to collect or enforce any personal or property right that supports payment or performance of the negotiable instrument (such as a guarantee or security right).

Rights to drawing proceeds from an independent undertaking

106. [*See* A/CN.9/WG.WGVI/WP.24/Add.2.]

Bank accounts

106 bis. The law should provide that after default a secured creditor with a security right in a bank account may exercise any remedy of secured creditors under this chapter. However, the right to collect on a bank account is, as against the depositary bank, subject to recommendation […].

[*Note to the Working Group: The Working Group may wish to note that the recommendation mentioned in recommendation 106 bis, which could be placed in a new section of the Guide dealing with third-party rights and obligations, could read along the following lines: "The law should provide that nothing in this Guide obligates a depositary bank to pay any person other than: (i) a person that is the depositary bank's customer with respect to the bank account, and (ii) a secured creditor who has control of the bank account pursuant to an agreement with the depositary bank."*]

107. The law should provide that after default a secured creditor who has control of a bank account is entitled to enforce its security right as a depositary bank if the secured creditor is a depositary bank or, if the depositary bank is not the secured creditor, in accordance with the terms of the agreement with the bank establishing control without having to resort to a court or other authority.

108. The law should provide that a secured creditor that does not have control of a bank account may enforce the security right against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

[*Note to the Working Group: The Working Group may wish to note that the following definition will be added to the terminology section of the Guide: "a secured creditor has "control" with respect to a bank account where: (i) the secured creditor is the depositary bank; (ii) the depositary bank has agreed to follow instructions from the secured creditor with respect to the bank account without further consent of the grantor (the agreement by which the depositary bank has agreed to follow instructions from the secured creditor with respect to the bank account without further consent of the grantor is referred to as a "control agreement"); or (iii) the secured creditor is the bank's customer as to the bank account".*]

Negotiable documents

109. The law should provide that after default the secured creditor has the right to enforce a negotiable document against the issuer or any other person obligated on the negotiable document. However, as between the secured creditor and the issuer or other person obligated on the negotiable document, the rights and obligations of those persons are determined by the law governing negotiable documents.

[*Note to Working Group: The Working Group may wish to note that 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. As more specifically provided in other recommendations of this chapter, the law should provide that a secured creditor after default is entitled to sell, lease,

license or otherwise dispose of an encumbered asset pursuant to recommendation 93(d).

110 bis. The law should provide that a secured creditor that disposes of encumbered assets without resorting to court or other authority may select the method, manner, time, place, and other aspects of the disposition.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that this recommendation is subject to the standard of good faith and commercial reasonableness set out in recommendation 89. It will also explain that the purpose and effect of this recommendation is to provide a balance between the interests of both the grantor (and its other creditors) and the secured creditor in enabling flexibility in the methods used to dispose of the encumbered assets toward the end of obtaining an economically effective realization, while at the same time protecting the grantor against actions taken by the secured creditor that, in the commercial context, are not reasonable.*]

Advance notice with respect to extrajudicial disposition of encumbered assets

111. The law should address whether a secured creditor is required to give notice with respect to extrajudicial disposition of an encumbered asset after default. Where the law requires such notice to be given, the law should:

(a) Specify that the notice should be given to: (i) the grantor, the debtor and any other person who owes payment of the secured obligation, (ii) any person with rights in the encumbered asset who, prior to the sending of the notice by the secured creditor to the grantor, has notified in writing the secured creditor of those rights, and (iii) any other secured creditor who, more than […] days before the notice is sent to the grantor has registered a notice of a security right in the encumbered asset under the name of the grantor or who was in possession of the encumbered asset at the time it was seized by the secured creditor;

(b) State the manner in which 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 98;

(c) Provide that any such notice should be in a language that is reasonably expected to inform its recipients about its contents (notice to the grantor is sufficient if it is in the language of the security agreement and, if the security right was made effective against third parties by registration, notice to all other persons is sufficient if it is in the language of the registry);

(d) Address the legal consequences of failure to comply with the recommendations governing notices with respect to extrajudicial dispositions; and

(e) List circumstances in which any such notice need not be given either because the time delay associated with requiring advance notice could have a negative effect on the realization value of the encumbered assets (as in the case of perishable tangibles or other assets whose value may decline speedily) or because the encumbered assets are of a sort sold on a recognized market (thereby obviating the need for advance notice).

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 grantor or other interested parties, while, at the same time, avoiding having a negative effect on the secured creditor's remedies and the potential realization value of the encumbered assets.

[*Note to the Working Group: The Working Group may wish to note that the commentary will explain that these rules should balance the interest of the secured creditor in having the flexibility to dispose of the encumbered asset promptly in order to take advantage of favourable market conditions (an interest that also benefits the grantor and other interested parties) with the interest of the grantor and those other parties in obtaining notice of the disposition sufficiently before the disposition in order to take actions that might further protect their interests (such as locating potential buyers for the encumbered asset or attending a public disposition of the encumbered asset to verify the secured creditor's compliance with its obligations under this chapter.*]

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 send the proposal, specifying the amount owed as of the date the proposal is sent and the amount of the obligation that is proposed to be satisfied by accepting the encumbered asset 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, more than […] days prior to the sending of the proposal by the secured creditor to the grantor, 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 [more than […] days before the proposal is sent to 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 to whom a proposal to accept an encumbered asset in total or partial satisfaction of the secured obligation must be sent under recommendation 114 objects in writing to such a proposal within [a short time, such as 20 days] after the proposal is sent, the secured creditor may not proceed with the proposal.

Surplus and shortfall

116. The law should provide that the enforcing secured creditor must apply the net proceeds of its enforcement (after deducting 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 competing claimant or as to the priority of payment, the enforcing secured creditor may, in accordance with generally applicable procedural rules, pay the surplus to a competent judicial or other authority or to a public deposit fund for distribution. In the case of such payment, the surplus should be applied in accordance with the priority rules of this law.

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

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

Right of prior-ranking secured creditor to take over enforcement

120. The law should provide that, at any time before final disposition, acceptance or collection of an encumbered asset, a secured creditor whose security right has priority over that of an enforcing [secured creditor] [competing claimant] is entitled to take control of the enforcement process initiated by that [secured creditor] [competing claimant]. The right to take control includes the right to continue enforcement initiated by the [secured creditor] [competing claimant], enforce by a different method provided in the recommendations of this chapter, and choose whether or not any remedy under the recommendations of this chapter 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 pursuant to the disposition acquires its right in the asset subject to rights that had priority over the security right of an enforcing [secured creditor] [competing claimant] but takes free of the rights of the grantor, the enforcing secured creditor and any competing claimant whose right has a lower priority than that of the enforcing secured creditor. The same rule applies to the title or other right acquired by a secured creditor who has accepted an encumbered asset in total or partial satisfaction of the secured obligation.

Title or other right acquired through judicial disposition

122. The law should provide that, if a secured creditor disposes of an encumbered asset through a judicial or other officially administered process, the title or other right acquired by the transferee is determined by the general rules of the State governing execution proceedings (for the distribution of the proceeds 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 the secured transactions law or the law governing enforcement of encumbrances on immovable property; and

(b) If an obligation to a secured creditor is secured by both a security right in an encumbered asset of the grantor and by an encumbrance on an immovable property of the grantor, the secured creditor may enforce both the security right and the encumbrance under the law governing enforcement of encumbrances on immovables or may enforce the security right under the secured transactions law and the encumbrance under 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.