United Nations A/CN.9/WG.VI/WP.27/Add.2

General Assembly

Distr.: Limited
27 April 2006

Original: English

United Nations Commission on International Trade Law
Working Group VI (Security Interests)
Tenth session
New York, 1-5 May 2006

Security Interests

Draft legislative guide on secured transactions

Note by the Secretariat

Addendum

Contents

V.06-53555 (E) 220506 220506

IX. Default and enforcement

A. General remarks

1. Introduction

1. A secured creditor usually expects a grantor[1] to perform its obligations without the need for the secured creditor to have recourse to the encumbered assets. A grantor will also typically expect to perform its secured obligations to the secured creditor. Both will recognize, however, that there will be times when the grantor will not be able to do so. The failure may result from poor management or business misjudgements, but it may also be for reasons beyond the grantor's control, such as an economic downturn in an industry or more general economic conditions.

2. Secured creditors generally will periodically review their grantors' business activities and the encumbered assets and communicate with those grantors who show signs of having financial difficulties. Grantors generally will cooperate with their secured creditors to work out ways to overcome these financial difficulties. A grantor and its creditors working together may enter into a "composition" or "work out" agreement that extends the time for payment, otherwise modifies the grantor's obligation or adds or reduces encumbered assets that secured the grantor's obligations. Negotiations to reach a composition agreement take place in the shadow of two principal legal factors: the secured creditor's right to enforce its security rights in the encumbered assets if the grantor defaults on its secured obligation and the possibility that insolvency proceedings will be initiated by or against the grantor. Even well short of formal processes, however, the grantor is likely to be well aware that it is not performing its obligations and only rarely, if ever, would it be the case that the grantor learns for the first time that it is in default by means of a notice from the secured creditor.

3. At the heart of a secured transactions regime is the right of the secured creditor to look to the amount that can be realized for the encumbered assets to satisfy the secured obligation if the grantor defaults. The availability of efficient and economical enforcement mechanisms that allow creditors accurately to predict the time and cost involved in the realization on the encumbered assets will have a significant impact on the availability and the cost of credit. A secured transactions regime should, therefore, provide efficient, predictable and economical procedural and substantive rules for the enforcement of a security right after a grantor has defaulted. These rules should be clear, simple and transparent to ensure certainty about the ability quickly to enforce a security right and efficiently at low cost to realize on the encumbered assets. At the same time, the rules should provide reasonable safeguards for the interests of the grantor other persons with an interest in the encumbered assets and the grantor's other creditors.

4. This chapter examines the secured creditor's enforcement of its security right if the grantor fails to perform ("defaults on"; see paras. 8-9) the secured obligation

---

[1] These general remarks use the term "grantor" as in the vast majority of cases the grantor is also the debtor. When a specific reference is limited to a third-party grantor that is not the debtor, the term "debtor" is used.

prior to the institution of insolvency proceedings or, with the permission of the appropriate body, during insolvency (insolvency is dealt with in chapter IX).

5. This Guide covers outright transfers of receivables. However, in such an outright transfer, the transferor has generally transferred all of its rights in the receivables. Thus, the transferor has no continuing right in the receivables and no interest in the realization (usually collection) of the receivables. Accordingly, this chapter applies to the outright transfer of a receivable only when the transferee has some recourse to the transferor for the non-collection of the receivables. It is only in that circumstance that the transferor has an interest in the method and other aspects of the collection or other disposition of the receivables.

6. Recourse to the grantor for the non-collection of receivables that have been the subject of an outright transfer may arise when the grantor has guaranteed some or all of the payment of the receivables by the account debtors. Recourse may also arise from other functionally equivalent arrangements, such as when (i) the grantor agrees to repurchase from the transferee a receivable sold to the transferee if the account debtor on the receivable fails to pay, or (ii) the grantor merely agrees to pay any deficiency between the purchase price for the bulk sale of receivables and the actual collections on the receivables.

7. Recourse to the grantor for "non-collection" as used here refers to non-collection because of the failure of the account debtor to pay for credit reasons, such as its financial inability to pay. Thus, for example, an account debtor's failure to pay for goods or services because of poor quality or failure of the grantor to comply with the account debtor's specifications for the goods or services would not be considered as non-collection as the term is referred to here.

2. Default

8. The parties' agreement and the general law of obligations will determine whether the grantor is in default and what are the consequences of default (e.g. if and how the grantor may cure the default and whether a notice of default is required).[2]

9. Generally speaking, the grantor is in default if it fails to perform the secured obligation and, upon the grantor's default, the secured creditor may enforce its security right against the encumbered assets. Normally, the grantor will seek to challenge before a court the secured creditor's position that the grantor is in default, or the calculation of the amount owing as a result of the default. To avoid unduly delaying rightful enforcement, the judicial review should be expedited. Safeguards should be built into the process to discourage grantors from making unfounded claims to delay enforcement. However, even if the grantor does not challenge the secured creditor on these issues prior to enforcement against the encumbered assets, the grantor is always able to raise these issues afterwards when the secured creditor seeks to collect any deficiency.

---

[2] This should be distinguished from a requirement that the secured creditor give notice prior to extra-judicial disposition of the encumbered asset.

3. Enforcement

(a) General considerations

10. It is important that the system take into account the rights of the grantor, other persons with a right in the encumbered assets and the grantor's other creditors. Many systems impose, as a general and overriding matter, a requirement that the secured creditor in enforcing its rights must act in good faith and follow commercially reasonable standards. Because of the importance of this obligation, the secured creditor and the grantor may not agree at any time to waive or vary this obligation. A secured creditor that does not comply with its obligations under this chapter should be liable to the persons injured by that failure for any damages caused by the failure. For example, if a secured creditor does not act in a commercially reasonable manner in disposing of the encumbered assets and that results in the secured creditor realizing a smaller amount for the encumbered assets than it would have realized had it acted in a commercially reasonable manner, the secured creditor should be liable to the person damaged for that differential.

11. Other than the obligation to act in good faith and in a reasonably commercial manner, the grantor and the secured creditor may, after the grantor's default, waive the other obligations described in this chapter. This approach protects the grantor from pressure from the secured creditor to waive or modify the obligation at the time the secured transaction is entered into. At the same time, allowing a waiver after the grantor's default would permit the facilitation of the grantor and the secured creditor "working out" in a non-adversarial way a disposition of the encumbered assets in a manner that maximises the amount that can be realized for the benefit of the secured creditor, the grantor, and the other creditors of the grantor. Moreover, at this stage, the secured creditor has already extended the credit, and it is often the case that the grantor, not the secured creditor, knows more about the encumbered assets and how most effectively to realize on the encumbered assets.

12. The key issue for a secured transactions regime is what modifications, if any, should be made to the normal rules for debt collection to facilitate the enforcement of security rights. Some regimes, for example, provide for expedited court proceedings. Other regimes permit the secured creditor, at least on a preliminary basis but subject to judicial intervention at the behest of the grantor and subject also to the obligations described above of good faith and commercial reasonableness, to determine if a breach has occurred, to take possession of the encumbered assets and to dispose of them with no direct judicial or administrative intervention. Expedited judicial and non-judicial procedures, however, should take into account the right of other persons to be heard in protection of their legitimate claims to the encumbered assets. Moreover, the allocation of resources within the judicial system and allowing private persons to take actions that affect others necessarily raise issues of public interest. When determining the role of the judiciary or other administrative authorities in the enforcement of security rights, it is essential to do so in a clear and straightforward manner.

13. All interested parties (i.e. the secured creditor, the debtor or grantor and other creditors) benefit from maximizing the amount that will be realized by disposing of the encumbered assets after the grantor has defaulted. The secured creditor benefits by the potential reduction of any deficiency the grantor may owe as an unsecured debt after application of the proceeds of the disposition of or collection on the

encumbered assets. At the same time, the grantor and the grantor's other creditors benefit from a smaller deficiency or a larger surplus. A secured transactions regime that decreases the hurdles and transaction costs of the disposition or collection, while obliging the secured creditor to exercise its remedies in good faith and in a commercially reasonable manner, will increase the amount of the proceeds received on disposition of the encumbered assets.

14. A security right is of particular importance to a secured creditor when the grantor is in financial difficulty. A grantor who is in financial difficulty is more likely to default on its obligations and may end up voluntarily or involuntarily in insolvency proceedings. The effect of insolvency proceedings on the rights of the secured creditor and the secured creditor's valuation of the encumbered assets are discussed in Chapter IX.

(b) Notice of intended extra-judicial disposition

15. Secured transactions laws that provide for non-judicial disposition normally require that notice of the intention to dispose of the encumbered assets be given to persons that may be affected by the disposition (e.g. the debtor, a third-party grantor and any person with rights in the encumbered assets) and specify the intended time and place of the disposition. The principal benefit of a notice of intended disposition to the debtor or grantor is that it alerts them to the need to protect their interests in the encumbered assets (the debtor will not be unaware of its default but the third-party grantor may be), such as by curing the debtor's default, if otherwise allowed, or by seeking potential buyers for the encumbered assets. Notice to other interested parties allows them to monitor subsequent enforcement by the secured creditor and, if they are secured creditors whose rights have priority (and the grantor is in default towards them as well), to participate in or take control of the enforcement process. The disadvantages of notice include its cost, the opportunity it provides an uncooperative grantor to remove the encumbered assets from the creditor's reach and the possibility that other creditors will race to assert claims against the grantor's business and interfere with the disposition process. Moreover, unless requirements with respect to notices are clear and simple, they generate the risk of "technical" non-compliance that generates litigation and inappropriate loss of rights. Many legal systems that require notice of intended disposition of the encumbered assets do not also require a notice of default (see paras. 8-9) or notice of extra-judicial enforcement.

[*Note to the Working Group: The Working Group may wish to note that, depending on whether recommendation 99 in document A/CN.9/WG.VI/WP.24/Add.1 dealing with notice of intention to pursue extrajudicial enforcement is retained or not, the commentary may have to be revised.*]

16. As with other situations where notice may be required, in those legal systems where a notice of default is required, secured transactions law normally states the minimum contents of a notice, the manner in which it is to be given and its timing. When doing so, the law might distinguish between notice to the debtor, notice to the grantor when the grantor is not the debtor, notice to other creditors and notice to public authorities or the public in general. It is a matter of a cost-benefit analysis whether the secured creditor should be required to give prior written notice to others beyond the debtor and grantor and other secured creditors known to exist, i.e., other secured creditors who have registered a notice of their interests or who have

otherwise notified the secured creditor who proposes to dispose of the encumbered assets. Alternatively, the registrar might be required to give such notice to those who have registered (see article 54 of the Inter-American Model Law). As for the information to be included in the notice to the debtor and grantor, likewise a cost-benefit analysis is required. The law might require the inclusion of the secured creditor's calculation of the amount owed as a consequence of default. It might further require advice to the debtor or grantor regarding what steps to take to pay the secured obligation in full or, if such a right exists, to cure the default. The secured creditor might also be required to indicate, at least provisionally, the steps it intends to take to dispose of the encumbered assets. Notice to other interested parties may not need to be as extensive or specific as that to the debtor and grantor.

(c) The extent of court supervision of enforcement

17. A key issue for a secured transactions regime is the extent to which the secured creditor must resort to the courts or other authorities (e.g. bailiffs, notaries or the police) to enforce its security right rather than to make use of out-of-court procedures. In order to protect the grantor and other parties with rights in the encumbered assets, some legal systems require the secured creditor to resort exclusively to the courts or other governmental authorities to enforce its security right. However, because court proceedings often cannot produce a result in a timely and cost-efficient manner or may well be less likely to produce the maximum possible amount for the encumbered assets, the requirement of court proceedings will negatively impact on the availability and the cost of credit. The time and cost involved reduce the amount that will be realized for the encumbered assets and will be factored into the cost of the financing transaction.

18. In order to avoid these problems, some legal systems do not require the secured creditor to use the courts or other governmental authorities in the enforcement process. Rather, the courts are at all times available at the behest of any interested person but do not intervene unless requested to do so by an interested person. A properly designed system can provide protection to the grantor and other persons with an interest in maximizing the amount that will be realized for the encumbered assets while at the same time providing an efficient system for realizing on the encumbered assets. In these legal systems the secured creditor is often authorized to enforce its security right without any prior intervention of official State institutions, such as courts, bailiffs or the police. In other legal systems, there is only limited prior intervention of official State institutions in the enforcement process. For example, the secured creditor may apply to a court for an order of repossession, which the court issues without a hearing (although the grantor may initiate an independent proceeding to challenge this order; see article 57 of the Inter-American Model Law). In such a case, once the secured creditor is in possession of the asset, it may sell it directly without court intervention following certain prescribed procedures (see article 59 of the Inter-American Model Law). The justification for such an approach lies in the fact that having the secured creditor or a trusted third party take control and dispose of the assets will often be more flexible, quicker and less costly than a State-controlled process. The availability of judicial intervention at the behest of any party and the legal obligations imposed on conduct often is sufficient to obviate the need to resort to the courts. The knowledge that judicial intervention is readily available is often sufficient to create the incentives to cooperative and reasonable conduct.

19. However, even in these legal systems the courts are available to ensure recognition of legitimate claims and defences of the grantor and other parties with rights in the encumbered assets. In order to inform these parties and give them an opportunity to react, the secured creditor may be required to give them a notice of intended disposition and possibly also a notice of default (see paras. 8-9). In addition, the secured creditor may not enforce its right to take possession of the encumbered assets if such enforcement would result in a disturbance of the public order. Moreover, in disposing of the encumbered assets, the secured creditor must act in a "commercially reasonable" manner (see para. 10). The purpose and effect of this requirement 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.

20. Even if permitted to act without official intervention, a secured creditor is normally also entitled to seek to enforce its security right by judicial action. The secured creditor may choose to bring a judicial action, rather than rely on its own actions, for a number of reasons. For example, the secured creditor may wish to avoid the risk of having its private actions challenged after the fact, or may conclude that it will have to bring a judicial action anyway to recover an anticipated deficiency. A secured creditor's decision to pursue remedies with or without judicial intervention does not prevent the secured creditor from later pursuing a different remedy.

21. Whether or not they require a secured creditor to resort to the courts, many legal systems modify the normal rules of civil procedure when a secured creditor seeks to enforce security rights. These modifications may limit the time within which the court must act or limit the claims or defences that the parties may raise. If the court concludes that there has been a default by the grantor, the objective of any decision is to satisfy the creditor's secured claim. The court is typically authorized to order the grantor to pay the obligation, to dispose of the encumbered assets under a court proceeding, or to turn over the assets to the secured creditor or to the court for disposition.

(d) Freedom of parties to agree to the enforcement procedure

22. Another key issue is the extent to which the secured creditor and the grantor may agree to modify the statutory framework for the enforcement of the security right. In some legal systems, the enforcement procedure is part of mandatory law that the parties cannot modify by agreement. In other legal systems, the parties are allowed to modify the statutory framework for enforcement as long as public policy, priority, and third-party rights (in particular in the case of insolvency) are not affected. In yet other legal systems, emphasis is placed on efficient enforcement mechanisms in which judicial enforcement is not the exclusive or the primary procedure. Even if a system has limits on the extent to which the secured creditor and the grantor may agree to modify the statutory framework, permitting the parties to agree freely on the consequences of their exchange after a default encourages an efficient allocation of resources. However, such freedom may be the subject of abuse at the time of conclusion of the security agreement. Thus, the law may

recognize only those agreements modifying the statutory framework that are reached after the grantor is in default. In any event, an agreement may not modify or waive the secured creditor's obligation to act in a commercially reasonable manner and in good faith (see para. 10).

(e) Acceptance of the encumbered assets in satisfaction of the secured obligation

23. Following default, the secured creditor may propose to the grantor that the secured creditor accept the encumbered assets in full or partial satisfaction of the secured obligation. Most jurisdictions make unenforceable an agreement entered into prior to default that automatically vests ownership of the encumbered assets in the secured creditor upon default, although some laws make an agreement entered into after default enforceable. The advantage of permitting agreements entered into after default is that, as a result of such an agreement, enforcement costs are minimized and the security right is enforced more quickly. This benefits the grantor as well as the secured creditor, since enforcement costs and risks are avoided by both parties. The disadvantage is that there may be a risk of abuse in the rare cases where both (i) the encumbered assets are more valuable than the secured obligation and (ii) the secured creditor has, even in the post-default situation, unusual power over the grantor and interested third persons.

24. The law may guard against abusive behaviour by the secured creditor in connection with such agreements by requiring the consent not only of the grantor but also notice to and failure to object by third parties with rights in the encumbered assets an absolute veto power held by any of the persons whose consent is required or who may lodge an objection should be quite sufficient as a safeguard against abuse. In addition, consent of a court might be required under certain circumstances, such as where the grantor has paid a substantial portion of the secured obligation. The law might also require an official appraisal of the encumbered assets. Again, a cost-benefit analysis should be made to determine whether to impose judicial involvement on this otherwise private process among consenting parties.

(f) Redemption of the encumbered assets

25. Most laws permit a defaulting grantor to redeem the encumbered assets before their disposition by the secured creditor by paying the outstanding amount of the secured obligation, including interest and the costs of enforcement incurred up to the time of redemption. Redemption brings the transaction to an end. The hope of redemption may encourage the grantor to search for potential buyers to purchase the encumbered assets and to monitor the secured creditor's acts closely. Redemption of the encumbered assets should be distinguished from reinstatement of the secured obligation. Reinstating the secured obligation (e.g. by paying a missed instalment before disposition), if permitted under the general law of obligations, cures a default and the restored obligation continues to be secured by the encumbered assets. Redemption of the encumbered assets occurs only when the secured obligation is discharged in full.

26. The grantor usually retains its right of redemption until (i) disposition of, or the completion of collection by the secured creditor on, the encumbered asset, (ii) the secured creditor entering into a commitment to dispose of the encumbered asset, or (iii) acceptance by the secured creditor of the encumbered asset in total or partial satisfaction of the secured obligation, which ever occurs first.

(g) Authorized disposition by the grantor

27. Following default, the secured creditor will be concerned about obtaining to the extent feasible the highest price possible for the encumbered assets. Frequently, the grantor will be more knowledgeable about the market for the assets than the secured creditor. For this reason, the grantor might be given a very limited period of time following default during which it is entitled to dispose of the encumbered assets. This might best be accomplished by the grantor's bringing the potential buyer to the attention of the secured creditor, rather than establishing a delay period in which the secured creditor cannot proceed with arrangements for the disposition of the encumbered assets. In any event, the regime should be structured so as to give the grantor the incentive to cooperate with the secured creditor.

(h) Removing the encumbered assets from the grantor's control

28. Upon the grantor's default, the secured creditor who is not already in possession of the encumbered assets will be concerned about potential dissipation or misuse of the assets. This may be alleviated by placing the assets in the hands of a court, a State official, a trusted third party or the secured creditor itself. Permitting the secured creditor to take possession without any or only limited recourse to a court or other authority reduces the costs of enforcement (see paras. 17-18). However, even those laws that permit such repossession by the secured creditor recognize the potential for abuse, especially the possibility of public disorder or intimidation. Most of these laws, therefore, condition repossession on avoiding a disturbance of the public order ("breach of the peace"). Some laws require prior notice of default as a precondition to taking possession. Other laws do not do so on the ground that a desperate grantor in default may then seek to hide or transfer the encumbered asset before the secured creditor may take possession of it.

29. In the special case where the encumbered assets threaten to decline rapidly in value, most laws provide for expedited, preliminary relief ordered by a court or other relevant authority to preserve the value of the assets.

(i) Sale or other disposition of the encumbered assets

30. A security right entitles the secured creditor to have the encumbered assets sold or otherwise disposed of. Law should provide additional general procedures for the disposition of the encumbered assets, which may provide for the secured creditor or a judicial authority to control the disposition. These should include the method of advertising a proposed disposition, whether to have a public auction and permission to sell, lease, license or collect upon the encumbered assets. The objective of the disposition should be to maximize the amount realized for the encumbered assets, while not jeopardizing the legitimate claims and defences of the grantor and other persons.

31. Requirements in existing legal systems range from the less to the more formal. Some legal systems require disposition subject to the same public procedures used to enforce court judgements. Other legal systems permit the secured creditor to control the disposition but prescribe uniform procedures for the disposition by public auction of encumbered assets, with rules on such matters as timing, publicity and minimum price. Yet other legal systems permit the secured creditor to make the disposition (including private disposition) of the encumbered assets—always subject

to independent standards, i.e. good faith and commercial reasonableness. The grant of flexibility provides benefits to the grantor, the secured creditor, others with an interest in the encumbered assets, and other creditors of the grantor because a formal public auction will not always be the best way to maximize the net recovery from the encumbered assets. These systems may condition the right of the creditor on the consent of the grantor, whether in the security agreement or after default. A general standard is usually prescribed which the secured creditor must observe (e.g. "commercially reasonable" or "with the care of a prudent business person"). There may also be special rules dealing with the manner by which the proceeds of a disposition are to be held pending distribution.

32. Most secured transactions laws share the requirements that notice must be given to certain parties with respect to a proposed disposition and the sale must be advertised or offers sought from appropriate parties. Due to the finality of any disposition, detailed rules are necessary to alert interested parties to protect their interest. Special procedures may be prescribed for the sale of a business as a going concern.

33. The collection of receivables and negotiable instruments may not fit easily into the procedures for disposition of the encumbered assets. Thus many systems have special rules for this type of encumbered asset, including giving the secured creditor the right to collect directly from the person obligated on the receivable or negotiable document and requiring that person to make any payments owed directly to the secured creditor (see para. 37).

(j) Allocation of proceeds of disposition

34. Secured transactions laws set out rules on the distribution of the proceeds of the disposition. The most common allocation is to pay reasonable enforcement costs first and then the secured obligation. Laws typically include rules prescribing if and when a secured creditor is responsible for distributing proceeds to some or all other secured creditors (such as secured creditors with junior security rights in the encumbered assets) with security rights in the same encumbered assets. These rules often require that notice of these other interests be given to the secured creditor and that any surplus proceeds are to be returned to the grantor.

35. The proceeds distributed to the secured creditor are applied towards the costs of the distribution and the satisfaction of the secured obligation. If there is a deficiency after the distribution, the obligation is discharged only to the extent of the proceeds received. The secured creditor is normally entitled to recover the amount of the deficiency from the grantor. Unless the grantor has created a security right in other assets for the benefit of the creditor, the creditor's claim for the deficiency is unsecured vis-à-vis the grantor (although the secured creditor may have received security rights from a third party).

(k) Finality

36. Secured transactions laws normally provide finality following disposition of the encumbered assets in favour of the person acquiring the encumbered asset through the disposition by the secured creditor. The secured creditor's security right in the encumbered assets terminates, as does the grantor's rights, and the rights of any junior secured creditor or other person with a lower ranking right in the

encumbered assets. The law normally provides that the rights of other persons in the encumbered assets (including other secured creditors) continue notwithstanding disposition of the assets in the enforcement procedure.

(l) Variations on general framework

37. Secured transactions law that includes within its scope many different types of encumbered assets provides, where necessary, special rules for the disposition of some types of asset. This is especially true of receivables, negotiable instruments, funds credited in a bank account or drawing proceeds from an independent undertaking, whether they are the original encumbered assets or they just secure payment or other performance of other obligations (see A/CN.9/WG.VI/WP.26, recs. 102 and 103; A/CN.9/WG.VI/WP.26/Add.1, recs. 106 bis-108). For example, a secured creditor with a security right in a receivable is normally entitled to inform the account debtor on the receivable to make payments directly to the secured creditor following the grantor's default. The notification and payment instruction can be sent by the secured creditor/assignee even in violation of an agreement with the grantor/assignor (see A/CN.9/WG.VI/WP.26, rec. 16 quater (b)). Otherwise, in the case of default on the part of the grantor/assignor (where the grantor/assignor will be reluctant to cooperate with the secured creditor/assignee), the secured creditor/assignee may be prevented from enforcing its security right. A secured creditor is also entitled to dispose of or retain a receivable (see A/CN.9/WG.VI/WP.24/Add.1, recs. 93 (d) and (e), 110 and 113).

38. If the security right is in funds credited to a bank account, the secured creditor may collect or otherwise enforce its right to payment of the funds after default or even before default if so agreed with the grantor. In any case, the depositary bank (i) has the same rights and obligations, (ii) the same rights of set-off, (iii) is not obliged to pay any person other than the person that has control of the account and (iv) respond to any requests for information (see A/CN.9/WG.VI/WP.26/Add.1, recs. X, Y and 106 bis-108). Unlike a secured creditor who has to collect first the funds and then apply them to the secured obligation, a depositary bank acting as a secured creditor may apply the funds directly to the secured obligation. The enforcement of the depositary bank's rights of set-off remains subject to other law.

39. If the security right is a negotiable instrument, the secured creditor may collect or otherwise enforce its security right (see A/CN.9/WG.VI/WP.26/Add.2, rec. 104). 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. For example, (i) 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 (ii) the right of the person obligated on the instrument to raise defences to that obligation is determined by the law governing negotiable instruments.

40. If the security right is in a negotiable document, the general rules on the enforcement of security rights apply. Special rules may apply to preserve the rights of certain persons protected under law governing negotiable documents (see A/CN.9/WG.VI/WP.26/Add.3, rec. 109). In particular, the issuer may be obligated to deliver the goods only to a holder of the negotiable document relating to them.

41. The general enforcement rules apply also to the enforcement of security rights in proceeds (except if the proceeds are receivables or other specific assets like the ones mentioned in the preceding paragraphs, in which case the asset-specific enforcement recommendations apply, see A/CN.9/WG.VI/WP.26/Add.4, note on enforcement of a security right in proceeds).

42. The same applies to the enforcement of security rights in attachments to movable property (e.g. automobile engines). As to the enforcement of security rights in attachments to immovable property, special rules apply to preserve the rights of creditors in the immovable property (see A/CN.9/WG.VI/WP.26/Add.4, note on enforcement of a security right in attachments). Such rules deal, for example, with the problem of severing an attachment (e.g. an elevator) from immovable property owned by someone other than the grantor.

43. Similarly, the general enforcement recommendations apply to the enforcement of security rights in masses (e.g. grain in a silo or oil in a tank) or products (e.g. cake produced from sugar, flour, eggs and water). For example, if the encumbered assets are oil of value 5 in a tank with oil worth 100, the secured creditor should be able to enforce its right only in oil of value 5. If the encumbered asset can be separated, the secured creditor should be able to dispose of that part only in a commercially reasonable manner. If the encumbered asset cannot be easily separated, the whole mass or product may have to be sold.

[*Note to the Working Group: As to the enforcement of security rights in movables by anticipation or crops, the Working Group may wish to consider first whether these types of asset should be covered at all (see A/CN.9/WG.VI/WP.26/Add.4, note on movables by anticipation and crops).*]

(m) Judicial proceedings brought by other creditors

44. Other creditors of the grantor may resort to the courts to enforce their claims against the grantor and procedural law may give these creditors the right to force the disposition of encumbered assets, subject to the interests of the secured creditor. The secured creditor will look to procedural law for rules on intervening in these judicial actions in order to protect its priority. In rare cases, procedural law may provide exceptions to general rules of priority. In some legal systems, for example, a court may order a person who owes money to a judgement debtor to pay the judgement creditor. If the court order may effectively give priority to the judgement creditor in an encumbered asset in which the secured creditor's security right is effective against third parties, the result is bound to affect the availability and cost of credit extended on the basis of encumbered assets.

B. Recommendations

[*Note to the Working Group: The Working Group may wish to note that the general recommendations on enforcement are contained in document A/CN.9/WG.VI/WP.24/Add.1, while the asset-specific recommendations on enforcement are contained in documents A/CN.9/WG.VI/WP.24/Add.2, as well as documents A/CN.9/WG.VI/WP.26 and Addenda 1 to 4.*]