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

Note by the Secretariat

Addendum

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

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

A. General rules

Article 47. Source of mutual rights and obligations of the parties

1. Article 47 is based on recommendation 110 of the Secured Transactions Guide (see chap. VI, paras. 14 and 15). It is intended to describe the universe of sources affecting the mutual rights and obligations of the parties to a security agreement: (a) the other articles of chapter VI of the draft Model Law; (b) other applicable law; (c) the terms of the security agreement (reiterating the principle of party autonomy enshrined in art. 4); and (d) any usage the parties have agreed upon and any practices the parties have established (thereby giving legislative strength to these usages and practices, which might not be generally recognized in all jurisdictions but which may nevertheless have important meaning to the parties).

2. With the exception of certain mandatory rules included in the chapter (see art. 4, para. 1), the parties are given wide latitude to tailor their security agreement and their usage and practices to the transaction at hand in order to most effectively and efficiently facilitate their respective commercial goals (as reflected in articles 6 and 11 of the Assignment Convention, as well as articles 6 and 9 of the CISG).

3. It is important to note that the person challenging the effectiveness of the agreement on the ground that it is inconsistent with this article bears the burden of proof.

Article 48. Obligation of a person in possession to exercise reasonable care

4. Article 48 is based on recommendation 111 of the Secured Transactions Guide (see chap. VI, paras. 24-31). It sets forth the rule that a grantor or secured creditor in possession of a tangible asset (which under the definition in art. 2, subpara. (kk), includes money, negotiable instruments, negotiable documents and certificated non-intermediated securities) must exercise reasonable care in physically preserving both the asset and its value. It does not apply to any party in possession of an encumbered asset, but only to the grantor or secured creditor in possession of the asset. A third party in possession of an encumbered asset would also be obliged to take reasonable care to preserve the encumbered assets, but only if that third party agreed to do so, and such an agreement should be enforceable under contract law.

5. What constitutes “reasonable care” in a given case depends upon the nature of the encumbered asset. Thus, reasonable care may mean something very different with respect to equipment, inventory, crops or live animals.

6. Although physical preservation of a tangible asset would, in most cases, have the effect of preserving the asset’s value, this rule also recognizes preservation of the asset’s value as an end in itself that may go beyond the physical preservation of the asset, and in some cases may go beyond the control of the grantor or secured

party in possession. For example, if a lender has possession of certificated non-intermediated shares of a borrower's wholly-owned subsidiary and actually takes over direct operation of the business of the subsidiary (a situation that would rarely happen in practice), article 48 could, depending on the particular circumstances, require the party in possession to exercise reasonable care in doing so.

7. Article 48 and a rule of securities law along the lines of article 5(1) of the Financial Collateral Directive ("FCD"), which gives a secured creditor the right to use securities in its possession, should be read together and their relationship would be a matter of domestic rules of interpretation. It should be noted that, according to article 1(4) of the FCD, financial collateral (a term that is, strictly speaking, not defined in the FCD) may consist of "cash" (see art. 2(1)(d) FCD), "credit claims" (see art. 2(1)(o) FCD), and/or "financial instruments" (see art. 2(1)(e) FCD). Under the FCD, "financial instruments" may be either intermediated ("book entry securities collateral"; see art. 2(1)(g) FCD) or non-intermediated securities, as long as they are tradable ("negotiable on the capital market" or "normally dealt in"; see art. 2(1)(e) FCD).

Article 49. Obligation of a secured creditor to return an encumbered asset [or to register an amendment or cancellation notice]

8. Article 49 is based on recommendations 112 and 72 of the Secured Transactions Guide (see chap. VI, paras. 35-39). It provides that, once a security right in an encumbered asset is extinguished, a secured creditor in possession of the asset must return it to the grantor and register an amendment or cancellation notice as provided in article 21, subparagraph 1 (b) or 2 (c) [of the registry-related provisions]. A security right generally will be deemed extinguished once the secured obligation is paid in full or otherwise satisfied in full, and all further commitments to extend credit to the debtor have terminated.

9. Article 49 does not expressly address the obligation of a secured creditor to withdraw any notifications that it has given to the debtor of the receivable. Rather, the grantor is protected in this regard by article 53, paragraph 2, and article 73, subparagraph 2 (b), which require the secured creditor to return to the grantor any surplus proceeds it receives.

10. This article does not apply to outright transfers of receivables, because the term "secured obligation" does not apply to outright transfers of receivables (see art. 2, subpara. (ff)), and receivables could not be the subject of physical possession (see art. 2, subpara. (z)).

11. The question of whether a secured creditor could return equivalent non-intermediated securities to replace the originally encumbered non-intermediated securities is a matter of securities law (see art. 5(2) FCD and A/CN.9/836, para. 24).

Article 50. Right of a secured creditor to use, be reimbursed for expenses and inspect an encumbered asset

12. Article 50 is based on recommendation 113 of the Secured Transactions Guide (see chap. VI, paras. 50-65). It provides that a secured creditor not only has certain obligations (described in articles 48 and 49), but also certain rights.

13. Under subparagraph 1 (a), a secured creditor in possession has the right to be reimbursed for the reasonable expenses incurred to preserve an encumbered asset in accordance with article 48.

14. Under subparagraph 1 (b), a secured creditor in possession may make reasonable use of an encumbered asset, so long as it applies any revenues generated from the use to the payment of the obligation secured by the asset.

15. Finally, under paragraph 2, where an encumbered asset is in the possession of the grantor, the secured creditor has the right to inspect the asset. As this article is subject to the general standard of commercial reasonableness and good faith set forth in article 5, the right to inspect may only be exercised at commercially reasonable times and in a commercially reasonable manner. The application of this standard depends upon the circumstances. For example, in extreme cases, such as where the debtor is in default or the secured creditor has reason to believe that the physical condition of the collateral is in jeopardy or has been, or is about to be, removed from the jurisdiction, the secured creditor may be justified in demanding an immediate inspection.

16. As article 50 is not one of the mandatory rules listed in article 4, paragraph 1, article 50 may be waived or modified by the parties to the security agreement. An agreement between the secured creditor and the grantor may affect the rights of a third party in possession of the encumbered asset only in the case where the third party is acting as the agent of the secured creditor.

B. Asset-specific rules

Article 51. Representations of the grantor of a security right in a receivable

17. Article 51 is based on recommendation 114 of the Secured Transactions Guide (see chap. VI, para. 73), which in turn is based on article 12 of the Assignment Convention. It provides that, when a grantor grants a security right in a receivable, the grantor is deemed to make various representations to the secured creditor at the time the security agreement is concluded.

18. In particular, under paragraph 1, the grantor represents that it has not previously created a security right in the receivable in favour of another secured creditor, and that the debtor of the receivable will not have any defences or rights of set-off with respect to the receivable. Under paragraph 2, the grantor does not represent that it has, or will have, the ability to pay the receivable.

19. As article 51 is not one of the mandatory rules listed in article 4, paragraph 1, any or all of the provisions of article 51 may be waived or modified by the parties to the security agreement. For this reason, a reference to contrary agreement of the parties, which was included in recommendation 114 of the Secured Transactions Guide, has been deleted.

20. Article 51 presents another difference with recommendation 114 of the Secured Transactions Guide. The representation that the grantor has the right to create a security right was not carried over into article 51, to avoid giving the impression that it applies to security rights created only in receivables. As a result, the matter is left to general contract law.

Article 52. Right of the grantor or the secured creditor to notify the debtor of the receivable

21. Article 52 is based on recommendation 115 of the Secured Transactions Guide (see chap. VI, paras. 74 and 75), which is based on article 13 of the Assignment Convention. Subparagraph 1 provides that, when a security right has been created in a receivable, either the grantor or the secured creditor has the right to notify the debtor of the receivable of the existence of the security right and give a payment instruction, but that once notification of the security right has been received by the debtor of the receivable, only the secured creditor may give a payment instruction.

22. Subparagraph 2 provides that a notification sent in breach of an agreement between the grantor of the security right and the secured creditor is nevertheless effective for the purposes of article 58, which precludes the grantor from raising, after receiving notice of the security right, certain rights of set-off with respect to the receivable that became available to the grantor after it received notice of the security right.

23. Although the express language of article 52, paragraph 1, refers to the right of the parties to "give" a notification of the security right and a payment instruction, it is clear from the draft Model Law that the notification is effective only when received by the debtor of the receivable, provided that the notification also meets the other requirements of article 56.

24. As article 52 is not one of the mandatory rules listed in article 4, paragraph 1, it may be waived or modified by the parties to the security agreement. For this reason, a reference to contrary agreement of the parties, which was included in recommendation 115 of the Secured Transactions Guide, has been deleted.

Article 53. Right of the secured creditor to payment of a receivable

25. Article 53 is based upon recommendation 116 of the Secured Transactions Guide (see chap. VI, paras. 76-80), which is based on article 14 of the Assignment Convention. Any changes made are intended to clarify the text, but not change its policy.

26. The article establishes the right of the secured creditor to receive the proceeds of a receivable in which it holds a security right as against the grantor of the security right. Paragraph 1 provides that, regardless of whether notification of the security right has been sent to the debtor of the receivable, the secured creditor is entitled to retain: (a) the proceeds of any full or partial payment of the receivable made to the secured creditor, as well as any tangible assets (such as inventory) returned to the secured creditor in respect of the receivable; (b) the proceeds of any full or partial payment of any receivable made to the grantor (as well as any tangible assets returned to the grantor); and (c) the proceeds of any full or partial payment of any receivable made to a third party (as well as any tangible assets returned to the grantor) if the right of the secured creditor has priority over the right of the third person.

27. As article 53 is not one of the mandatory rules listed in article 4, paragraph 1, it may be waived or modified by the parties to the security agreement. For this reason, a reference to contrary agreement of the parties, which was included in recommendation 116 of the Secured Transactions Guide, has been deleted.

Article 54. Right of the secured creditor to preserve encumbered intellectual property

28. Article 54 is based on recommendation 246 of the Intellectual Property Supplement (paras. 223-226). It recognizes the effectiveness of an agreement between the grantor of a security right in intellectual property and the secured creditor that the secured creditor may take the necessary steps to preserve the value of the intellectual property, such as making any necessary registration (such as a patent registration) and initiating actions to prevent infringement by third parties.

29. Although articles 4 (party autonomy) and 48 (obligation to preserve an encumbered asset) may be generally sufficient to ensure that the secured creditor may take these steps, article 54 has been inserted in to the draft Model Law, because, in an intellectual property right context, these rights are normally rights of the intellectual property owner.

Section II. Rights and obligations of third-party obligors

A. Receivables

Article 55. Protection of the debtor of the receivable

30. Article 55 is derived from recommendation 117 of the Secured Transactions Guide (see chap. VII, para. 12), which is based on article 15 of the Assignment Convention. Paragraph 1 sets forth the general principle that the creation of a security right in a receivable does not affect the rights or obligations of the debtor of the receivable, unless the debtor of the receivable consents.

31. To implement the general principle of paragraph 1, paragraph 2 provides that a payment instruction may change the person, address or account to which the debtor of the receivable is required to make payment, but it may not change: (a) the currency in which the receivable is to be paid, as specified in the original contract giving rise to the receivable; or (b) the State in which the payment is to be made, as specified in the original contract giving rise to the receivable, to a State other than that in which the debtor of the receivable is located.

Article 56. Notification of a security right in a receivable

32. Article 56 is based on recommendation 118 of the Secured Transactions Guide (see chap. VII, paras. 13-16), which is based on article 16 of the Assignment Convention. It describes the requirements for an effective: (a) notification to a debtor of a receivable of the existence of a security right in the receivable; or (b) payment instruction with respect to the receivable.

33. Under paragraph 1, for the effectiveness of both a notification and a payment instruction, they must be “received” by the debtor of the receivable. In addition, both must reasonably identify the receivable and the secured creditor, and be in a language reasonably expected to inform the debtor of its contents. On this latter point, paragraph 2 makes it clear that the language of the original contract evidencing the receivable is always sufficient.

34. Under paragraph 3, both a notification and payment instruction may relate not only to receivables in existence at the time the notification or payment instruction is given, but also may relate to receivables arising thereafter.

35. Under paragraph 4, where A creates a security right in its receivables and then transfers them to B, who also creates a security right in the receivables and then transfers them to C, who also creates a security right in the receivables, notification of the debtor of the receivable relating to the security right created by C constitutes notification of all prior security rights created by A and B.

Article 57. Discharge of the debtor of the receivable by payment

36. Article 57 is based on recommendation 119 of the Secured Transactions Guide (see chap. VII, paras. 17-20), which is based on article 17 of the Assignment Convention. It sets forth the rules affecting when and how a receivable is discharged by payment.

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

38. First, under paragraph 3, if the debtor of the receivable receives more than one payment instruction relating to a single security right in a receivable created by the same grantor, it is discharged by paying in accordance with the last payment instruction received from the secured creditor before payment, as the last payment instruction will be the most up-to-date. Second, under paragraph 4, if the debtor is notified of the existence of more than one security right in the same receivable created by the same grantor, it is discharged by paying in accordance with the first notification received, on the theory that the security right covered by the first notification will probably have priority over the subsequent security right under the draft Model Law's priority rules.

39. Third, under paragraph 5, if the debtor receives notification of one or more subsequent security rights in the same receivable, it is discharged by paying in accordance with the notification of the last of such subsequent security rights. The reason is that the last in a series of transferees/secured creditors will be the actual holder of the security right.

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

41. Finally, under paragraph 8, if the debtor receives notification from a [subsequent secured creditor][a secured creditor that acquires its right from the initial or any other secured creditor], to be protected, it may request from the secured creditor to provide, within a reasonable time, proof of the creation of the security right by the initial grantor to the initial secured creditor and any intermediate security right. If the secured creditor fails to provide such proof, the debtor may pay as if it had not received such notification. For this purpose, under paragraph 9, adequate proof includes any writing from the grantor that indicates a security right has been created (e.g. a security agreement).

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

Article 58. Defences and rights of set-off of the debtor of the receivable

43. This article is based on recommendation 120 of the Secured Transactions Guide (see chap. VII, para. 21), which is based on article 18 of the Assignment Convention. It must be read in conjunction with article 59. Subparagraph 1 preserves for the debtor all defences and rights of set-off arising from the contract giving rise to the receivable, including any other contract that was part of the same transaction, as if the security right had never been created and the claim were made by the grantor. Subparagraph 1 is subject to a contrary agreement of the parties as provided in article 59. Subparagraph 1 (b) ensures that the debtor of the receivable can assert against the secured creditor any other right of set-off that was available to the debtor at the time it received notification of the security right. This means, however, that the debtor may not assert a right of set-off that arises subsequent to such notification.

44. Under paragraph 2, paragraph 1 does not give the right to the debtor of the receivable to raise against the secured creditor as a defence or right of set-off the breach of an agreement by the grantor limiting the grantor's right to create a security right. Otherwise, the validation of a security right under article 12 notwithstanding such an agreement would be meaningless.

Article 59. Agreement not to raise defences or rights of set-off

45. Article 59 is based on recommendation 121 of the Secured Transactions Guide (see chap. VII, para. 22), which is based on article 19 of the Assignment Convention. Paragraph 1 provides that the debtor of the receivable may agree, in a writing signed by it, not to raise the defences and rights of set-off permitted by article 58. Under paragraph 2, any modification to such an agreement must also be in a writing signed by the debtor of the receivable and is effective as against the secured creditor only if the secured creditor consents or, in the case of a receivable that has not been earned yet by performance, a reasonable secured creditor would consent. To avoid abuses, paragraph 3 provides that the debtor may not waive defences based on fraud committed by the secured creditor or the debtor's incapacity.

Article 60. Modification of the original contract

46. This article is based on recommendation 122 of the Secured Transactions Guide (see chap. VII, paras. 23 and 24), which is based on article 20 of the Assignment Convention. It addresses the impact of an agreement between the grantor of a security right in a receivable and the debtor of the receivable that modifies the terms of the receivable. The result depends on when the agreement is made.

47. Under paragraph 1, if the agreement is concluded before the debtor receives notification of a security right in the receivable, it is effective against the secured creditor, although the secured creditor also [enjoys any benefits derived from the agreement].

48. Under paragraph 2, even if the agreement is concluded after notification, it is also effective, even if it affects the secured creditor's rights if either: (a) the secured creditor consents to it; or (b) the receivable has not been fully earned by performance and the modification was provided for in the original contract giving rise to the receivable or a reasonable secured creditor would consent to the modification.

49. Paragraph 3 provides that article 60 does not affect any right of the grantor or secured creditor arising under other law for breach of an agreement between them (such as an agreement that the grantor would not agree to any modifications of the terms of the receivable).

Article 61. Recovery of payments made by the debtor of the receivable

50. Article 61 is based on recommendation 123 of the Secured Transactions Guide (see chap. VII, paras. 25 and 26), which is based on article 21 of the Assignment Convention. It addresses the situation in which the grantor of a security right in a receivable (or the transferor in an outright transfer of the receivable) fails to perform its obligations under the contract giving rise to the receivable. The article insulates the secured creditor from liability in this circumstance, by providing that the debtor of the receivable may not look to the secured creditor to recover any amount that it has paid to either the grantor or the secured creditor. As a result, the debtor of the receivable bears the risk of the insolvency of its contractual partner (i.e. the grantor).

B. Negotiable instruments

Article 62. Rights as against the obligor under a negotiable instrument

51. Article 62 is based on recommendation 124 of the Secured Transactions Guide (see chap. VII, paras. 27-31). It is intended to preserve the rights of parties under the applicable law relating to negotiable instruments. For example, a secured creditor with a security right in a negotiable instrument may collect from the obligor under the instrument only in accordance with its terms; also, even if the grantor defaults, the secured creditor cannot collect from the obligor before payment becomes due under the instrument and the law relating to such instruments.

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

Article 63. Rights as against the depositary bank

52. Article 63 is based on recommendations 125 and 126 of the Secured Transactions Guide (see chap. VII, paras. 32-37). It addresses the situation in which a security right is granted in a right to payment of funds credited to a bank account.

53. Paragraph 1 provides that the rights and obligations of the depositary bank are unaffected by the security right, unless the bank consents. The rationale for protecting banks in this manner is that imposing duties on a depositary bank or changing the rights and duties of a depositary bank without its consent may subject the bank to risks that it is not in a position to manage appropriately unless it knows in advance what those risks might be (see chap. VII, para. 33).

54. To safeguard the confidentiality of the relationship of a bank and its client, paragraph 1 also provides that the depositary bank has no obligation to respond to requests for information (e.g. about the balance in the account, whether a control agreement exists or whether the account holder retains the right to dispose of funds credited to its bank account).

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

D. Negotiable documents and tangible assets covered

Article 64. Rights as against the issuer of a negotiable document

56. Article 64 is based on recommendation 130 of the Secured Transactions Guide (see chap. VII, paras. 43-45). It provides that, when a secured creditor has a security right in a negotiable document, the rights of the secured creditor as against the issuer of the document or any person obligated on the document are determined by the law relating to negotiable documents. This means that, for a secured creditor with a security right in the document to enforce it against the assets covered by the document: (a) at the time of enforcement, the assets covered by the document must still be in the possession of the issuer or other obligor under the document; and (b) the issuer or other obligor will have no obligation to deliver the assets to the secured creditor, unless the negotiable document was transferred to the secured creditor in accordance with the law governing negotiable documents (e.g. with a necessary endorsement).

E. Non-intermediated securities

Article 65. Rights as against the issuer of a non-intermediated security

57. As already mentioned, the Secured Transactions Guide did not address security rights in any types of securities (see rec. 4, subpara. (c)). Thus, article 65 is a new rule. In line with articles 62-64, it provides that the rights of a secured creditor

holding a security right in non-intermediated securities as against the issuer of the securities are determined by other law of the enacting State. For example, under that law, governmental approval, specific formalities, payment of a special tax, registration on the books of a corporation, or special enforcement procedures may be required with respect to a security right in the shares of a domestic corporation.

Chapter VII. Enforcement of a security right

A. General rules

Article 66. Post-default rights

58. Article 66 is based on recommendations 133, 139, 141, 143, and 144 of the Secured Transactions Guide (see chap. VIII, paras. 10-12, 15-17, 33-35). Paragraph 1 clarifies that, following the debtor's default, the grantor and the secured creditor may exercise any right they may have under the provisions of chapter VII, as well as under the security agreement and the law governing the security agreement, provided that it is not inconsistent with the provisions of the draft Model Law.

59. The meaning of the term "default" is generally defined in paragraph 1. Its exact meaning, however, is subject to the agreement of the parties and the law governing the agreement. It should also be noted that some of the grantor's rights under this article would be available to the grantor even before default under contract law (e.g., the right of redemption and the right to apply to a court or other authority for relief).

60. Paragraphs 2 and 3 indicate that the exercise of one right generally does not prevent the exercise of another right, except if the exercise of one right makes impossible the exercise of another right (e.g. if the secured creditor decides to obtain possession and sell the encumbered asset, it cannot propose to acquire it in satisfaction of the secured obligation).

61. Paragraph 4 provides that the grantor and others who may owe payment of the secured obligation may not waive or vary their rights under this chapter before default. Otherwise, the secured creditor could put pressure on any debtor of the secured obligation to waive or vary their rights in return for concession in the security agreement (see Secured Transactions Guide, chap. VIII, paras. 16 and 17).

Article 67. Methods of exercising post-default rights

62. Article 67 is based on recommendation 142 of the Secured Transactions Guide (see chap. VIII, paras. 18-20 and 29-33). Paragraph 1 clarifies that the secured creditor may exercise its post-default rights by applying or without applying to a court or other authority to be specified by the enacting State (e.g. a chamber of commerce, arbitration tribunal or notary public). The enacting State may wish to indicate whether any rights specified in this chapter must be exercised by application to a court or other authority (e.g. the right to obtain possession and the right to dispose of an asset). In any case, in view of the fact that legal systems differ as to which post-default rights may be exercised only by an application to a court or other authority (e.g. the right to obtain possession and the right to dispose of an

asset), the draft Model Law does not introduce any limitation to the ability of the parties to avail themselves of the assistance of a court or other authority at any time to exercise a post-default right or resolve a dispute arising in that respect (A/CN.9/836, para. 52).

63. Under paragraph 2, the exercise of post-default rights by application to a court or other authority is subject to the relevant rules to be specified by the enacting State, while, under paragraph 3, the exercise of those rights without application to a court or other authority is subject to the provisions of this chapter.

Article 68. Relief for non-compliance

64. Article 68 is based on recommendation 137 of the Secured Transactions Guide (see chap. VII, para. 31). It is intended to indicate that, if a person's rights are affected by another person's non-compliance with its obligations under the provisions of this chapter, the first person is entitled to relief by a court or other authority. A violation of the secured creditor's obligations includes violations by the secured creditor's agents, employees or service providers. Persons that may be affected include: a secured creditor with a lower priority ranking than that of the enforcing secured creditor, a guarantor or a co-owner of the encumbered assets.

65. The enacting State may wish to specify the court or other authority to which the party seeking relief should apply and the type of expeditious proceeding that would be available. That authority may include an arbitral tribunal, chamber of commerce or notary public (provided that there is an arbitration agreement between the grantor and the secured creditor that is enforceable under the law of the enacting State). In such a case: (a) the arbitral agreement (and award) would bind only the parties thereto; and (b) if the winning party attempts to seize an asset, the law of the enacting State must provide protection for the rights of persons, who are not party to the arbitration agreement, in the encumbered assets. In this case, third-party creditors should be notified (e.g. before an extrajudicial sale takes place, as provided in article 72) and given an opportunity to assert their rights (e.g. their right to take over enforcement, as provided in article 70, or be paid from the proceeds of a sale according to their priority rank, as provided in article 73).

66. As protracted and expensive enforcement proceedings are likely to have a negative impact on the availability and the cost of credit, enacting States are encouraged to provide for expedited court proceedings (including proceedings for interim measures of protection and preliminary orders).

Article 69. Right of affected persons to terminate the enforcement process

67. Article 69 is based on recommendation 140 of the Secured Transactions Guide (see chap. VIII, paras. 22-24). Under paragraph 1, any person whose rights are affected by the enforcement process is entitled to terminate the enforcement process by paying or otherwise performing the secured obligation in full. This provision is based on the assumption that the residual value of the asset is higher than the outstanding part of the secured obligation. It should be noted that the extinction of a security right, which was also addressed in recommendation 140 of the Secured Transactions Guide, is addressed in article 11bis.

68. Full payment includes the reasonable cost of enforcement. This means that: (a) in the case of enforcement before a court or other authority, the court or other

authority would set the cost of enforcement based on evidence; and (b) in the case of enforcement without an application to a court or other authority, the grantor could seek the assistance of a court or other authority if it were to dispute the reasonableness of the cost of enforcement.

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

[*Note to the Working Group: The Working Group may wish to note that the reference to article 69, paragraph 3, in paragraph 69 above appears within square brackets, because article 69, paragraph 3, is also within square brackets*.]

Article 70. Right of the higher-ranking secured creditor to take over enforcement

70. Article 70 is based on recommendation 145 of the Secured Transactions Guide (see chap VIII, para. 36). Paragraph 1 clarifies that a secured creditor, whose security right has priority over that of the enforcing secured creditor or judgement creditor ("higher-ranking secured creditor"), has the right to take over the enforcement process. The higher-ranking secured creditor may take over the enforcement process at any time before the asset is sold or otherwise disposed of, or acquired by the secured creditor or until the conclusion of an agreement by the secured creditor for that purpose. [Like article 69, paragraph 3, paragraph 3 of this article, allows the exercise of this right even after the encumbered asset has been leased or licensed, without, however, affecting the rights of lessees or licensees.]

71. Under paragraph 3, the right of the higher-ranking secured creditor to take over the enforcement process includes the right to enforce by any of the methods foreseen in this chapter. This means that the higher-ranking secured creditor may change the method of enforcement, for example to correct mistakes made by the enforcing creditor. It should be noted, however, that the exercise of this right is subject to the standard of article 5, paragraph 1, that is, the secured creditor would be obliged to act in good faith and in a commercially reasonable manner, for example, to avoid unnecessary enforcement costs.

Article 71. Right of the secured creditor to possession of an encumbered asset

72. Article 71 is based on recommendations 146 and 147 of the Secured Transactions Guide (see chap. VIII, paras. 38-48 and 51-56). Paragraph 1 clarifies that, after default, the secured creditor is entitled to obtain possession of an encumbered asset by applying to a court or other authority. The opening words of paragraph 1 are intended to clarify that the mere fact that the grantor defaulted does not automatically give the secured creditor the right to obtain possession of the encumbered asset from a person that obtained its rights free of the security right (e.g. buyer or other transferee, a lessee or licensee; see art. 29).

73. Under paragraph 2, the secured creditor is also entitled to obtain possession of an encumbered asset without applying to a court or other authority if all the

conditions set out therein are met. The enacting State may wish to specify how long before seeking possession the secured creditor must give notice.

74. [Under paragraph 3, the secured creditor may take possession only after the short period of time (to be specified by the enacting State), and not upon receipt of the notice by its addressees.]

75. Under paragraph 4, to avoid damage to perishable assets or speedy loss of value of an encumbered asset [such as an intermediated security], the notice referred to in subparagraph 2 (b) need not be given.

[*Note to the Working Group: The Working Group may wish to note that the commentary to paragraphs 3 and 4 will be prepared after their finalization*.]

Article 72. Right of the secured creditor to dispose of an encumbered asset

76. Article 72 is based on recommendations 148-151 of the Secured Transactions Guide (see chap. VIII, paras. 48 and 57-60). Paragraph 1 deals with the secured creditor's right to sell or otherwise dispose of, lease, or license an encumbered asset by applying or without applying to a court or other authority (to be specified by the enacting State); and paragraph 2 provides that the enacting State is also to specify the rules that will determine the method, manner, time, place and other aspects of the sale or other disposition, lease or licence.

77. Paragraphs 3-8 deal with dispositions by the secured creditor without an application to a court or other authority. Under paragraph 3, the secured creditor may determine the aspects of the sale or other disposition, lease or licence. Under paragraph 4, the secured creditor must give to the grantor, any debtor and any person with rights in the encumbered asset that notifies in writing the secured creditor of those rights a notice that contains all the elements set out in paragraphs 5-7. Under paragraph 8, the notice need not be given if the encumbered asset is perishable, may decline in value speedily or is of a kind sold on a recognized market.

78. Subject to its obligation to act in good faith and in a commercially reasonable manner (see art. 5, para. 1), the secured creditor may: (a) dispose of the encumbered assets by public or private sale, and if by public sale, through auction or tender (see A/CN.9/836, para. 68); and (b) decide whether to dispose of the encumbered assets individually, in groups or as a whole (see Secured Transactions Guide, chap. VIII, paras. 71-73).

Article 73. Right of the secured creditor to distribute the proceeds of disposition of an encumbered asset

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

80. Under paragraph 2, the distribution of the proceeds of a sale or other disposition, lease or licence without an application to a court or other authority is subject to the rules set forth in paragraph 2. Subparagraph 2 (b) refers only to payment to a

subordinate secured creditor, because, under article 75, paragraphs 3 and 4, the security right of a higher-ranking secured creditor is preserved even after enforcement by a lower-ranking secured creditor.

81. Under paragraph 3, if after distribution of the proceeds there is a shortfall, the debtor has a personal (unsecured) obligation to pay.

82. It should be noted that: (a) this article does not apply to outright transfers of receivables; and (b) damages for non-compliance with enforcement obligations under the provisions of this chapter are a matter for other law, in particular in relation to consumer transactions (see A/CN.9/836, para. 73).

Article 74. Right of the secured creditor and the grantor to propose the acquisition of an encumbered asset by the secured creditor

83. Article 74 is based on recommendations 156-159 of the Secured Transactions Guide (see chap. VIII, paras. 65-70). Paragraph 1 states the right of the secured creditor to propose in writing to acquire one or more of the encumbered assets in total or partial satisfaction of the secured obligation. Paragraphs 2 and 3 deal with the addressees and the contents of the proposal. The proposal must be sent to: (a) the grantor and any debtor; and (b) certain other persons.

84. Paragraph 4 provides that: (a) in the case of a proposal for the acquisition of the encumbered asset in full satisfaction of the secured obligation, the secured creditor acquires the encumbered asset, if none of the addressees objects; (b) in the case of a proposal for the acquisition of the encumbered asset in partial satisfaction of the secured obligation, the secured creditor acquires the encumbered asset if all of the addressees consent. The latter approach is intended to safeguard the rights of all addressees of the notice, since they will remain liable for part of the secured obligation.

85. Under paragraph 5, if the grantor makes such a proposal and the secured creditor accepts it, the secured creditor must proceed as provided in paragraphs 2-4.

Article 75. Rights acquired in an encumbered asset

86. Article 75 is based on recommendations 160-163 of the Secured Transactions Guide (see chap. VIII, paras. 74-81). It is intended to deal with the finality of rights acquired in an encumbered asset pursuant to the enforcement of a security right (e.g. whether a transferee acquires its rights free or subject to the security right). Paragraph 1 deals with sales or other dispositions under the supervision of a court or other authority and refers finality of rights to the law to be specified by the enacting State. Paragraph 2 deals with leases and licences of encumbered assets under the supervision of a court or other authority and provides that the lessee or licensee acquires its rights to use the leased or licensed asset except as against creditors with rights that have priority over the right of the enforcing secured creditor.

87. Under paragraphs 3 and 4, in the case of a sale or other disposition, lease or licence of an encumbered asset, the buyer or other transferee acquires its rights subject only to rights that have priority over the security right of the secured creditor, and the lessee or licensee is entitled to the benefit of the lease or licence except as against creditors with rights that have priority over the rights of the secured creditor.

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

[*Note to the Working Group: The Working Group may wish to note that part of paragraph 88 above appears within square brackets as the relevant text in article 75, paragraph 5, also appears within square brackets.*]

B. Asset-specific rules

Article 76. Collection of payment under a receivable, negotiable instrument, right to payment of funds credited to a bank account or non-intermediated security

89. Article 76 is based on recommendations 169-171, 173 and 175 of the Secured Transactions Guide (see chap. VIII, paras. 93-98, 102-108, 111 and 112). It is intended to indicate that where the encumbered asset is an obligation to pay money, after default, the secured creditor is entitled to collect payment from the obligor.

90. Under paragraph 2, the secured creditor may exercise the right to collect even before default but with the agreement of the grantor; and, under paragraph 3, the secured creditor may also enforce any personal or property right that secures or supports payment of the encumbered asset.

91. Paragraph 4 is intended to protect a depositary bank from the obligation of having to pay against its consent without a decision by a court or other authority. As a result of paragraph 4, the secured creditor may collect the balance credited in a bank account without applying to a court or other authority only if the security right in the right to payment of the funds has been made effective against third parties by the security right being created in favour of the depositary bank, the conclusion of a control agreement or the secured creditor becoming the account holder (see art. 23).

Article 77. Collection of payment under a receivable by an outright transferee

92. Article 77 is based on recommendations 167-168 of the Secured Transactions Guide (see chap. VIII, paras. 99-101). It clarifies that, in the case of an outright transfer of a receivable, the transferee is entitled to collect the receivable before or after default. It should be noted that, under article 5, paragraph 2(b), the standards of good faith and commercial reasonableness do not apply to an outright transfer of a receivable without recourse to the transferor, as the grantor (transferor) had no remaining vested interest in the receivable that could be protected by a limitation on the way in which the secured creditor (transferee) could collect the receivable.