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

Note by the Secretariat

Addendum

Contents

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

1. Chapter VI deals with the pre-default rights and obligations of the parties and third-party obligors (chapter VII deals with the post-default rights and obligations of the parties). With the exception of articles 53 and 54 which are mandatory rules, the provisions of chapter VI are non-mandatory, and thus do not apply if the parties have agreed otherwise. This approach, which is based on the recommendations of the Secured Transactions Guide and the provisions of the Assignment Convention, is reflected as a general rule in article 3, paragraph 1, rather than specifically in the provisions of chapter VI.

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

A. General rules

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

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

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

3. Article 53 is based on recommendation 111 of the Secured Transactions Guide (see chap. VI, paras. 24-31). It sets out the mandatory law rule (see para. 1 above) that a grantor or secured creditor in possession of a tangible asset (which under the definition in art. 2, subpara. (ll), includes money, negotiable instruments, negotiable documents and certificated non-intermediated securities) must exercise reasonable care to preserve the asset. Whether a person other than the grantor and the secured creditor that is in possession of an encumbered asset is obliged to take reasonable care to preserve the encumbered asset is determined under other law.

4. What constitutes “reasonable care” in a given case depends upon the nature of an asset. Thus, it may mean something different with respect to equipment, inventory, crops or live animals. For example, precious metals may have to be kept in a vault and inventory in a warehouse, a cow has to be milked, a valuable musical instrument has to be played and a racing horse has to exercise. According to article 4, a person must exercise its rights and perform its obligations, including the obligation to preserve the value of the asset, in good faith and in a commercially reasonable manner.

5. Unlike recommendation 111 of the Secured Transactions Guide, on which it is based, article 53 refers only to the preservation of the asset, and not to the preservation of the asset’s value. This does not reflect a change of policy but is, rather, due to the fact that: (a) in most cases, physical preservation of a tangible asset would have the effect of preserving the asset’s value; and (b) in some cases, preservation of the asset’s value may go beyond the physical preservation of the asset and could place an undue burden on the person in possession. For example, a person in possession of certificated non-intermediated shares of a company may be required to exercise certain rights attached to the shares (e.g. the right to collect dividends or the right to vote), but should not be obliged to participate in an increase of the capital of an enterprise to preserve the value of the encumbered shares.

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

6. Article 54 is based on recommendations 112 and 72 of the Secured Transactions Guide (see chap. VI, paras. 35-39). It sets out a mandatory law rule (see para. 1 above) that, once a security right in an encumbered asset is extinguished, a secured creditor in possession of the asset must return it to the grantor or deliver it to a person designated by the grantor (in some jurisdictions, delivery to a person designated by the grantor may be viewed as a means of returning the asset to the grantor). Under article 4, the grantor is obliged to exercise the right to designate another person in good faith and in a commercially reasonable manner (e.g. by avoiding placing an undue burden on the secured creditor). In exercising its right to deliver the asset to the grantor or a person designated by the grantor, the secured creditor also must comply with the same standard. The same standard should apply to the question as to who should bear any additional cost incurred by the secured creditor. For example, any such additional cost may have to be borne by the debtor in the same way as costs of performance of the debtor's obligation under the credit and security agreement are normally payable by the debtor. It should be noted that where a security right in an encumbered asset is extinguished, and the security right had been made effective against third parties, not by possession, but by registration, the secured creditor is obliged to register an amendment or cancellation notice. This this issue is addressed in article 20, paras. 1, 2 and 3 of the Model Registry Provisions. The issue of when a security right is extinguished is addressed in article 12 of the Model Law.

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

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

8. Article 55 is based on recommendation 113 of the Secured Transactions Guide (see chap. VI, paras. 50-65) and sets out a law rule, which the parties may vary or derogate from by agreement (see para. 1 above). Under paragraph 1 (a), a secured creditor in possession of an encumbered asset has the right to be reimbursed for reasonable expenses incurred to preserve it in accordance with article 53. Under paragraph 1 (b), a secured creditor in possession of an encumbered asset may make reasonable use of it and apply any revenues generated from the use to the payment of the obligation secured by the asset.

9. A rule of law relating to securities that entitles a secured creditor to use securities in its possession if the security agreement so provides should be read together with article 55. Their relationship would be a matter for the rules of the applicable law.

10. 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 out in article 4, the right to inspect may only be exercised at reasonable times and in a commercially reasonable manner. The application of this standard depends upon the circumstances. For example, in extreme cases, such as where the secured creditor has reason to believe that the physical condition of the collateral is in jeopardy or has been, or is about to be, removed from the State of its location, the secured creditor may be justified in demanding an immediate inspection.

Article 56. Right of the grantor to obtain information

11. Article 56 is intended to provide the grantor with the right to obtain information from a secured creditor as to the amount of the secured obligation or the assets encumbered at a certain point of time. This information may be necessary where the grantor is interested in obtaining credit against the security of assets that are already encumbered (and are subject to a notice registered against the grantor in the Registry) and the potential third-party creditor requests that information. The parties may vary or derogate from the rule set out in article 56 (see para. 1 above).

12. Under paragraph 1, the secured creditor is obliged to provide this information within a short period of time specified by the enacting State (e.g. 7 to 14 days) after receipt of the grantor's request. This obligation does not apply to an outright transfer of receivables by agreement, however, as the case of such an outright transfer there is no secured obligation.

13. Under paragraph 2, the grantor is entitled to one response free of charge during a short period of time specified by the enacting State (e.g. one year). Under paragraph 3, the secured creditor is entitled to require payment of a nominal fee for any additional response. The grantor should exercise this right and the secured creditor should perform this obligation in good faith and in a commercially reasonable manner (e.g. the grantor should avoid repeated and unnecessary requests, and the secured creditor should provide the information in a commercially reasonable way that can be readily understood). Other matters, such as the legal consequences of the secured creditor's failure to comply with a request for information or to give accurate information are left to other law (in the same way as breach of any of other obligations in this chapter is left to other law). The enacting State may wish to consider the question whether to extend this to information right to third-party creditors (e.g. judgment creditors).

B. Asset-specific rules

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

14. Article 57 is based on recommendation 114 of the Secured Transactions Guide (see chap. VI, para. 73), which in turn is based on article 12 of the Assignment Convention. It provides that, unless otherwise agreed (see para. 1 above), when a grantor grants a security right in a receivable, the grantor is deemed to make various representations to the secured creditor at the time the security agreement is concluded. In particular, under paragraph 1, the grantor represents that it has not previously created a security right in the receivable in favour of another secured creditor, and that the debtor of the receivable will not have any defences or rights of set-off with respect to the receivable (i.e. that the grantor will fully perform the contract giving rise to the receivable and any other contract it has entered into with the debtor of the receivable).

15. Paragraph 2 reflects the generally accepted principle that, unless otherwise agreed (see para. 1 above), the grantor does not guarantee the solvency of the debtor of the receivable. As a result, the risk of debtor default is on the secured creditor, a fact that the secured creditor will take into account in determining whether to extend credit and on what conditions. Recognizing the right of the parties to financing transactions to agree on a different risk allocation, paragraph 2 allows the grantor and the secured creditor to agree otherwise. Such an agreement may be implicit or explicit. The question of what constitutes an implicit agreement is left to the applicable contract interpretation rules. In addition, it should be noted that such an agreement may refer to the solvency the debtor of the receivable at the time when the security agreement is entered or at the time when the receivable will become payable.

16. The representation that the grantor has the right to create a security right was not carried over from recommendation 114 of the Secured Transactions Guide into article 57, to avoid giving the impression that it applies to security rights created only in receivables. As a result, the matter is left to general law. It should be noted, however, that even where an anti-assignment agreement is included in the contract giving rise to the receivable or other agreement between a grantor and the debtor of the receivable, the grantor still has rights in the receivable or the power to encumber it, and thus may create an effective security right in the receivable (see arts. 6, para. 1, and art. 13, para. 1).

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

17. Article 58 is based on recommendation 115 of the Secured Transactions Guide (see chap. VI, paras. 74 and 75), which in turn is based on article 13 of the Assignment Convention. It sets out a rule, which the parties may vary or derogate from by agreement (see para. 1 above). Paragraph 1 provides that, when a security right has been created in a receivable, either the grantor or the secured creditor has the right to notify the debtor of the receivable of the existence of the security right and send a payment instruction; however, once notification of the security right has been received by the debtor of the receivable, only the secured creditor may send a payment instruction. It should be noted that, under article 62, a notification or a payment instruction is effective only when received by the debtor of the receivable.

18. It should be noted that, while they may be included in the same document, a payment instruction is conceptually distinct from a notification. The former normally explains to the debtor of the receivable how it is to make payment and the latter typically informs the debtor of the receivable that it owes its obligations to a different person. For example: (a) a notification may contain no payment instruction (e.g. because the secured creditor may have obtained control of the grantor's bank account to which debtors of receivables have been instructed by the grantor to pay); (b) the parties may have agreed that no notification but only a payment instruction will be given (e.g. because the transaction involved is a non-notification factoring or undisclosed invoice discounting transaction); and (c) the secured creditor may need to change its payment instructions and thus there may be more than one payment instruction.

19. Paragraph 2 provides that a notification sent in breach of an agreement between the grantor and the secured creditor is nevertheless effective for the purposes of article 63. This means that the debtor of the receivable that pays in accordance with that notification is discharged (see paras. 29-36 below). However, article 58 does not affect any obligation or liability that the secured creditor may have under other law for sending a notification to the debtor of the receivable in breach of an agreement with the grantor.

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

20. Article 59 is based upon recommendation 116 of the Secured Transactions Guide (see chap. VI, paras. 76-80), which in turn is based on article 14 of the Assignment Convention. Changes made are intended to clarify the text, but not to change its policy. Article 59, which the parties may vary or derogate from by agreement (see para. 1 above), reiterates the right that a secured creditor with a security right in a receivable has (as against the grantor) under article 10 to receive the proceeds of the encumbered receivable.

21. 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: (a) retain 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) payment of 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) payment of the proceeds of any full or partial payment of any receivable made to another person (as well as any tangible assets returned to that person) if the right of the secured creditor has priority over the right of that person.

22. Paragraph 2 provides that, unless otherwise agreed (see para. 1 above), the secured creditor has the right to collect the full amount of the encumbered receivable, but has to account for and return to the grantor any surplus remaining after payment of the secured obligation (art. 79, para. 2, contains a similar rule). In the case of an outright transfer of a receivable by agreement, however, under paragraph 2, the transferee may retain the full amount collected, as that will be the "value" of its right in the receivable.

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

23. Article 60 is based on recommendation 246 of the Intellectual Property Supplement (paras. 223-226). It reiterates the principle of party autonomy set out in article 3, paragraph 1 (which is based on rec. 10 of the Secured Transactions Guide) and parallels the rule in article 53 (which is based on rec. 111 of the Secured Transactions Guide and applies only to tangible assets) to ensure that, if so agreed with the grantor, the secured creditor would be entitled to exercise rights that are normally rights of the intellectual property right holder (e.g. to deal with authorities, renew registrations and pursue infringers, even before default, provided that it is not prohibited by law relating to intellectual property). This is important, as, if the grantor (the intellectual property right holder) failed to exercise these rights in a timely fashion, the value of the encumbered intellectual property could diminish, and this could negatively affect the use of intellectual property as security for credit.

Section II. Rights and obligations of third-party obligors

A. Receivables

Article 61. Protection of the debtor of the receivable

24. Article 61 is derived from recommendation 117 of the Secured Transactions Guide (see chap. VII, para. 12), which in turn is based on article 15 of the Assignment Convention. Paragraph 1 sets out the general principle that the creation of a security right in a receivable does not affect the rights or obligations of the debtor of the receivable, unless the debtor of the receivable consents. So, for example, without the consent of the debtor of the receivable, the creation of a security right cannot change the payment terms of a contract giving rise to a receivable (e.g. the amount or the time of payment), alter the defences or rights of set-off that the debtor of the receivable may raise under the contract giving rise to the receivable or increase expenses in connection with payment of the receivable.

25. Whatever change is effected in the legal position of the debtor of the receivable as a result of the creation of a security right in the receivable, under paragraph 2 a payment instruction (whether given together with the notification or subsequently) may change the person, address or account to which the debtor of the receivable is required to make payment, as these changes do not affect the rights or obligations of the debtor of the receivable. However, a payment instruction may not change: (a) the currency in which the receivable is to be paid, as specified in the contract giving rise to the receivable; or (b) the State in which the payment is to be made, as specified in the contract giving rise to the receivable, to a State other than that in which the debtor of the receivable is located. This is because these changes would affect the debtor's rights and obligations. It should be noted that, unlike the Assignment Convention that includes in article 5, subparagraph (h), a rule of

interpretation as to the location of a person for the purposes of the Convention, the Model Law includes in article 90 such a rule that applies only in the context of chapter VIII on conflict of laws. Thus, for example, the location of the debtor of the receivable referred to in paragraph 2 (b) should be understood in the light of other law of the enacting State.

Article 62. Notification of a security right in a receivable

26. Article 62 is based on recommendation 118 of the Secured Transactions Guide (see chap. VII, paras. 13-16), which in turn is based on article 16 of the Assignment Convention. It describes the requirements both for an effective notification of a security right in a receivable and for a payment instruction (which is conceptually distinct from a notification, see para. 18 above).

27. Under paragraph 1, a notification or a payment instruction is effective from the time when it is received by the debtor of the receivable, if it reasonably identifies the receivable and the secured creditor, and is in a language reasonably expected to inform the debtor of its contents. On this latter point, paragraph 2 makes it clear that the language of the contract giving rise to the receivable is always sufficient. Under paragraph 3, a notification (which may include a payment instruction or not) may relate not only to receivables in existence at the time the notification is given, but also may relate to receivables arising thereafter.

28. Paragraph 4 addresses a scenario where a receivable is the subject of multiple successive security rights (whether they secure payment or other performance of an obligation or are outright transfers; see art. 2, subpara. (kk)). The following example illustrates the operation of paragraph 4. A, to whom a receivable is owed, creates a security right in the receivable in favour of B. B then creates a security right in the receivable in favour of C. C then creates a security right in the receivable in favour of D. Notification to the debtor of the receivable relating to the security right created by C in favour of D will also constitute notification of the prior security rights created by A and B. The same result would arise if A transferred receivables to B, B then transferred them to C, and C thereafter transferred them to D. Notification to the debtor of the receivable relating to the outright transfer from C to D constitutes notification of the outright transfer from A to B.

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

29. Article 63 is based on recommendation 119 of the Secured Transactions Guide (see chap. VII, paras. 17-20), which in turn is based on article 17 of the Assignment Convention. It sets out the rules dealing with the discharge of the debtor of the receivable by payment. It should be noted that the debtor of the receivable is discharged by payment in accordance with this article, even if payment is not made to the secured creditor that has priority. It should also be noted that this article and all articles of the Model Law with the exception of articles 72-82 apply also to outright transfers of receivables by agreement (see art. 1, para. 2).

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

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

creditor before payment, as the last payment instruction will be the most recent (a payment instruction is conceptually distinct from notification; see para. 18 above).

32. Second, under paragraph 4, if the debtor of the receivable receives notification of more than one security right in the same receivable created by the same grantor, it is discharged by paying in accordance with the first notification received. In this way, the debtor of the receivable, having received one notification of a security right, need not concern itself whether the grantor retained any right to create a second security right and, if so, which notification should be complied with. This rule also reflects the fact that it is likely that the security right covered by the first notification will have priority over the subsequent security right under the Model Law's priority rules. As already noted (see para. 29 above), the debtor of the receivable is discharged even if the first notification does not relate to the security right with priority, since the debtor cannot be required to determine which security right has priority. In such a case, the secured creditor with a security right that has priority will have to claim the proceeds of payment from the creditor to whom the debtor made the payment.

33. Third, under paragraph 5, if the debtor of the receivable 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 following example illustrates the operation of paragraph 5. A, to whom a receivable is owed, creates a security right in the receivable in favour of B. B creates a security right in the receivable in favour of C. If the debtor of the receivable receives a notification from each of B and C, it will be discharged by paying C. The reason is that the last in such a series of successive secured creditors is most likely to be the person entitled to payment. One side effect of this rule, along with the rule in paragraph 4, is that the debtor of the receivable needs to be able to distinguish between multiple notifications relating to security rights granted by the same grantor (in which case the debtor of the receivable must pay in accordance with the first notification) and notifications of multiple subsequent security rights (in which case the debtor of the receivable must pay in accordance with the last notification). This matter is addressed in paragraph 8 (see para. 35 below).

34. Fourth, under paragraph 6, where the debtor of the receivable 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 is discharged by paying either in accordance with the notification or in accordance with paragraph 1 as if the debtor had 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.

35. Finally, under paragraph 8, if the debtor of the receivable receives notification from a person claiming to have a security right in the receivable and wants to make sure that that person is a secured creditor to whom payment will discharge the debtor of the receivable, the debtor of the receivable may request that person to provide, within a reasonable time, adequate proof of the creation of the security right. If the asserted security right was created by an initial or subsequent secured creditor, the adequate proof must include proof of the initial and subsequent security rights. If the person claiming to have a security right fails to provide the required proof, the debtor may pay as if it had not received the notification sent by that person. For this purpose, under paragraph 9, adequate proof includes any writing from the grantor that indicates that a security right has been created (e.g. a security agreement).

36. Paragraph 10 is intended to preserve any other ground for discharge based on payment to the person entitled to payment, as well as payment to a competent judicial or other authority, or to a public fund, under other law. For example, under paragraph 10, the debtor of the receivable is discharged if it pays the right person pursuant to a notification conforming with the requirements of the other applicable law but not with the requirements of articles 2 (y), 62 and 63, paragraphs 1-9. Similarly, the debtor of the receivable is discharged by making payment to a

competent judicial or other authority, or to a public fund if so provided by the applicable law (e.g. where the debtor of the receivable receives notifications by different secured creditors and is not certain whom to pay in order to be discharged).

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

37. Article 64 is based on recommendation 120 of the Secured Transactions Guide (see chap. VII, para. 21), which in turn is based on article 18 of the Assignment Convention. Paragraph 1 (a) preserves, for the benefit of the debtor of the receivable, all defences and rights of set-off arising from the contract giving rise to the receivable, including any other contract that was part of the same transaction, as if the security right had never been created and the claim were made by the grantor. Paragraph 1 (b) ensures that the debtor of the receivable can assert against the secured creditor any other right of set-off that was available to the debtor at the time it received notification of the security right. This means, however, that the debtor may not assert a right of set-off other than that set out in paragraph 1 (a) that arises subsequent to such notification. Under article 65, however, the debtor may agree not to raise the above-mentioned defences and rights of set-off against the secured creditor.

38. Consistent with article 13, paragraph 2, paragraph 2 of article 64 provides that paragraph 1 does not give the debtor of the receivable the right to raise against the secured creditor, as a defence or right of set-off, the breach of an agreement by the grantor that limits the grantor's right to create a security right in the receivable. Otherwise, the validation of a security right notwithstanding such an agreement, as provided in article 13, would be meaningless.

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

39. Article 65 is based on recommendation 121 of the Secured Transactions Guide (see chap. VII, para. 22), which in turn is based on article 19 of the Assignment Convention. Paragraph 1 provides that the debtor of the receivable may agree, in a signed written agreement with the grantor, not to raise against the secured creditor the defences and rights of set-off that it could otherwise raise against that secured creditor under article 64. The secured creditor is entitled to invoke the benefit of such an agreement even though it is not a party to it.

40. Under paragraph 2, any modification to such an agreement must also be in a written agreement between the grantor and the debtor of the receivable that is signed by the debtor of the receivable. Such a modification is only effective as against the secured creditor if the secured creditor consents or, in the case of a receivable that has not been earned yet by performance, a reasonable secured creditor would consent (see art. 66, para. 2).

41. To avoid abuses, paragraph 3 provides that the debtor may not waive defences based on fraud committed by the secured creditor or on the debtor's incapacity (see art. 30 of the Bills and Notes Convention). Paragraph 3 does not prevent the debtor of the receivable (e.g. the buyer in a sales agreement) from waiving defences relating to fraud committed by the grantor (e.g. the seller). If the debtor of the receivable could not waive such defences, the secured creditor would have to conduct an investigation in this regard and this could result in uncertainty.

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

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

creditor, but the secured creditor also enjoys any benefits derived from the agreement.

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

Article 67. Recovery of payments

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

B. Negotiable instruments

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

45. Article 68 is based on recommendation 124 of the Secured Transactions Guide (see chap. VII, paras. 27-31). It is intended to preserve the rights of parties under the relevant law of the enacting State relating to negotiable instruments (to be specified by the enacting State in its enactment of this article). For example, if the enacting State's law is substantively identical to the Bills and Notes Convention: (a) the maker of a note is obliged to pay the secured creditor with a security right in the note only if the secured creditor is a holder of the note or has paid it; (b) the maker of a note is obliged to pay the secured creditor only when payment becomes due under the terms of the note; (c) if the secured creditor is a "protected holder" of a note, the defences that the maker of the note may raise against the secured creditor may be significantly limited. It should be noted that the reference in article 68 (as well as arts. 70 and 71) to other relevant law relating to negotiable instruments to be specified by the enacting State will be the law of the enacting State's law only if that law is the applicable law under the conflict-of-laws rules of chapter VIII.

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

Article 69. Rights as against the deposit-taking institution

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

47. Paragraph 1 (a) provides that the rights and obligations of the deposit-taking institution are unaffected by the security right, unless the institution consents. The rationale for protecting deposit-taking institutions in this manner is that imposing

duties on such an institution or changing the rights and duties of the institution without its consent may subject that institution to risks that it is not in a position to manage appropriately unless it knows in advance what those risks might be, and to the risk of having to violate obligations imposed by other law, such as sanctions law (see Secured Transactions Guide, chap. VII, para. 33).

48. To safeguard the confidentiality of the relationship of a deposit-taking institution and its client that is imposed by regulatory or other law, paragraph 1 (b) also provides that the deposit-taking institution has no obligation to respond to requests from third parties 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).

49. Paragraph 2 addresses situations in which the deposit-taking institution has a security right in the right to payment of funds credited to a bank account maintained at that institution and also has a right of set-off against that right to payment of funds. The paragraph provides that the deposit-taking institution's right of set-off is not limited by the security right. Thus, if, under applicable law of set-off, the set-off rights are broader than the rights of a secured creditor under the Model Law, the deposit-taking institution may avail itself of those broader rights. The policy rationale for this rule is the need to protect the general operations of deposit-taking institutions and to preserve the rights of set-off that a deposit-taking institution may have under other law (see Secured Transactions, chap. VII, para. 34).

D. Negotiable documents and tangible assets covered by negotiable documents

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

50. Article 70 is based on recommendation 130 of the Secured Transactions Guide (see chap. VII, paras. 43-45). It provides that, when a secured creditor has a security right in a negotiable document, the rights of the secured creditor as against the issuer of the document or any person obliged on the document are determined by the law relating to negotiable documents of the enacting State (to be specified by the enacting State in its enactment of this article).

E. Non-intermediated securities

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

51. As already mentioned, the Secured Transactions Guide does not address security rights in any types of securities (see rec. 4 (c)). Thus, article 71 has no antecedent in the Secured Transactions Guide. In line with articles 68-70, it provides that the rights of a secured creditor holding a security right in non-intermediated securities as against the issuer of the securities are determined by other law of the enacting State (to be specified by the enacting State in its enforcement of this article).

Chapter VII. Enforcement of a security right

A. General rules

Article 72. Post-default rights

52. Article 72 is based on recommendations 133, 139, 141, 143, and 144 of the Secured Transactions Guide (see chap. VIII, paras. 10-12, 15-17, and 34 and 35). Paragraph 1 provides that, following the grantor's default, the grantor and the

secured creditor may exercise any right they have under the provisions of chapter VII, other law or the security agreement, provided that, in the last two cases, that right is not inconsistent with the provisions of the Model Law. In denying effect to any inconsistent terms of the security agreement, this proviso indirectly operates to limit party autonomy in relation to enforcement (for an additional limit to party autonomy, see para. 55 below).

53. For the purposes of the Model Law, "default" is defined to mean the failure of the debtor to pay or otherwise perform the obligation secured by the security right and any other event agreed to by the parties in their security agreement as constituting "default" (see art. 2, subpara. (j)). It should be noted that the only one of the secured creditor's rights provided in this chapter that may be exercised before default is the right to collect an encumbered receivable (see art. 82, para. 2, and 83).

54. The Model Law adopts the policy that maximizing flexibility in enforcement is likely to increase the efficiency of the enforcement process (see Secured Transactions Guide, rec. 143 and chap. VIII, para. 34). Accordingly, paragraph 2 indicates that the exercise of one post-default right does not prevent the exercise of another post-default right, except if the exercise of one right makes it impossible to exercise of the other right. For example, a secured creditor that obtains possession of an encumbered asset under article 77 with the initial intention of disposing of it under article 78 may thereafter propose to acquire it in satisfaction of the secured obligation under article 80, unless the secured creditor has already sold or agreed to sell the asset.

55. Paragraph 3 provides that, before default, neither the grantor nor the debtor (defined to include a secondary debtor such as a guarantor of the secured obligation; see art. 2, subpara. (h)) may waive unilaterally or vary by agreement its rights under this chapter. In the absence of this provision, a secured creditor with superior bargaining power could put pressure on them to waive or vary their rights before default in return for concessions in the security agreement (see Secured Transactions Guide, chap. VIII, paras. 16 and 17). After default, this is no longer an issue and thus the grantor or the debtor may waive or vary its rights under the provisions of this chapter.

56. With the exception of article 83, the provisions of this chapter do not apply to an outright transfer of receivables by agreement (see art. 1, para. 2). Consequently, the terms "encumbered asset", "grantor", "secured creditor", "security agreement" and "security right" in articles 72-82 should be read with this exclusion in mind.

Article 73. Methods of exercising post-default rights

57. Article 73 is based on recommendation 142 of the Secured Transactions Guide (see chap. VIII, paras. 18-20 and 29-33). Paragraph 1 provides that the secured creditor has a choice to exercise its post-default rights judicially (i.e. by application to a court or other authority vested with adjudicative power) or extra-judicially (i.e. without an application to a court or other authority). It should be noted that public notaries, bailiffs, sheriffs or other court enforcement officers typically assist in enforcement by a court or other authority but do not have adjudicative powers to resolve disputes and issue decisions binding on all parties.

58. There are a number of reasons why a secured creditor may prefer to exercise its post-default rights by application to a court or other authority. For example: (a) judicial or similar proceedings may not be efficient; (b) the secured creditor may wish to avoid having its extrajudicial actions subsequently challenged; (d) the secured creditor may anticipate that it will have to apply to a court or other authority anyway to recover an anticipated deficiency; or (d) the secured creditor may fear and wish to avoid a breach of public order (see Secured Transactions Guide, chap. VIII, paras. 32 and 33).

59. A secured creditor may instead elect to exercise its post-default rights extra-judicially because, for example, it fears that judicial proceedings may be too

slow and costly, or less likely to produce an appropriate amount upon the disposition of the encumbered assets (see Secured Transactions Guide, chap. VIII, paras. 29 and 31).

60. Under paragraph 2, the secured creditor's judicial exercise of its post-default rights is subject to the provisions of this chapter and to the provisions that are specified for this purpose by the enacting State. As inefficient enforcement mechanisms are likely to have a negative impact on the availability and the cost of credit (see Secured Transactions Guide, chap. VIII, para. 29), paragraph 2 also refers to expeditious enforcement proceedings. Such proceedings may, for example, include proceedings involving only affidavit evidence, proceedings in which hearings are held, challenges are disposed of and decisions are rendered in as expeditious a manner as possible, and proceedings in which court decisions are executed without an official seizure or sale of assets (see Secured Transactions Guide, chap. VIII, para. 33).

61. Under paragraph 3, the extrajudicial exercise by the secured creditor of its post-default rights is governed by the provisions of this chapter. These provisions incorporate advance notice and other procedural protections for the grantor, the debtor and third parties whose rights may be affected. For example, under article 77, paragraph 2, the secured creditor may exercise its extra-judicial right to possession of the encumbered asset only if it has the grantor's advance written consent, notified the grantor and any person in possession of the debtor's default and of its intent to obtain possession, and the person in possession does not object (see further para. 72 below).

62. Moreover, a secured creditor's extrajudicial exercise of its post-default rights is subject to the overarching obligation in article 4 to exercise those rights in good faith and in a commercially reasonable manner. In this respect, it should be noted that the Model Law does not preclude recourse to the assistance of a court or other authority at any time to resolve a dispute arising in relation to the extrajudicial exercise of a post-default right. To the contrary, under article 74, if the secured creditor does not comply with its obligations under this chapter, the grantor, any person with a right in the encumbered asset or the debtor (option A), or any person whose rights are affected by the non-compliance of another person with the provisions of the Model Law (option B) is entitled to apply for expeditious relief from the court or other authority specified by the enacting State.

Article 74. Relief for non-compliance

63. Article 74 is based on recommendation 137 of the Secured Transactions Guide (see chap. VII, para. 31). It addresses the availability of relief from a court or other specified authority in the case of a person's non-compliance with its obligations under the provisions of this chapter. It also requires the enacting State to specify the court or other authority to which the party seeking relief should apply and to provide also for expeditious forms of proceedings (see para. 60 above).

64. Two options are provided for the enacting State to choose between. The first option addresses non-compliance only by the secured creditor, and provides that relief may be sought by: (a) the grantor; (b) any other person with a right in the encumbered asset whose rights are affected by that non-compliance; or (c) the debtor. The second option is broader, addressing non-compliance by any person, and giving any person affected by that non-compliance the right to seek relief. It should be noted that a breach of the secured creditor's obligations under the provisions of this chapter would typically include a breach by persons acting on behalf of the secured creditor (such as representatives, employees or service providers). It should also be noted that the persons that may be affected include: (a) a competing claimant; (b) a guarantor of the secured obligation; or (c) a co-owner of an asset in which another co-owner has created a security right.

Article 75. Right of affected persons to terminate enforcement

65. Article 75 is based on recommendation 140 of the Secured Transactions Guide (see chap. VIII, paras. 22-24). Paragraph 1 entitles the grantor, any other person with a right in the encumbered asset or the debtor to terminate the enforcement process by paying or otherwise performing the secured obligation in full (this right is known in some jurisdictions as the right to "redeem" the encumbered asset). In practice, this right is likely to be exercised when the value of the encumbered asset is significantly higher than the amount of the obligation secured by the security right of the enforcing secured creditor. It should be noted that, unlike recommendation 140 of the Secured Transactions Guide, article 75 does not address the extinguishment of a security right, because this matter is addressed in article 12 of the Model Law.

66. Full payment, for the purposes of paragraph 1, includes payment of the reasonable cost of enforcement incurred by the secured creditor whose enforcement is sought to be terminated. If the party exercising the termination right challenges the reasonableness of the enforcing creditor's statement of its enforcement costs and enforcement was initiated by an application to a court or other authority, this dispute would be resolved by the relevant authority. In the case of extrajudicial enforcement, the party exercising the termination right may seek the assistance of a court or other authority specified in article 74 to determine whether the secured creditor's assertion that the cost of enforcement is reasonable.

67. Under paragraph 2, the right to terminate enforcement is extinguished once the relevant enforcement process has reached a point when the asset is no longer available to be the subject of enforcement (see para. 69 below). Thus, this right cannot be exercised once the secured creditor has sold or otherwise disposed of, acquired or collected the encumbered asset, or entered into an agreement for the sale or other disposition of the encumbered asset. Otherwise, the finality of acquired rights would be undermined (see further paras. 90-93 below). Under paragraph 3, the right to terminate enforcement may still be exercised even after the secured creditor has enforced its security right by entering into a lease or licence agreement under article 78. However, the party exercising the termination right must respect the rights of the lessee or licensee under its agreement with the secured creditor whose enforcement has been terminated.

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

68. Article 76 is based on recommendation 145 of the Secured Transactions Guide (see chap VIII, para. 36). Paragraph 1 deals with a situation where a lower-ranking secured creditor or a judgment creditor has commenced enforcement. It entitles a secured creditor, whose security right has priority over that of the enforcing creditor ("higher-ranking secured creditor") to take over enforcement. The right of the higher-ranking secured creditor to take over enforcement, if it so wishes, is justified because of the potential impact of enforcement on its rights. In particular, if a subordinate creditor exercises its right to dispose of the encumbered asset judicially, the security right of the higher-ranking secured creditor will usually be extinguished (see art. 81, para. 1, and para. 90 below) and replaced by a right to priority of payment out of the proceeds realized by the subordinate creditor (see art. 79, para. 1 and para. 81 below); it therefore has an interest in controlling the enforcement process. If the subordinate creditor instead exercises its disposition right extra-judicially, the security right of the higher-ranking creditor will follow the asset into the hands of the transferee to whom the enforcing creditor disposes of the asset (see art. 81, para. 3, and para. 91 below), thereby potentially forcing the higher-ranking secured creditor to commence enforcement proceedings against that transferee.

69. As in the case of the right of termination in article 75, the right of the higher-ranking secured creditor to take over the enforcement process under this article must be exercised before the asset is sold or otherwise disposed of, acquired, or collected by the subordinate creditor or before the conclusion of an agreement by the subordinate creditor with a third party to dispose of the encumbered asset. This is so because, after that time, the asset is no longer available to be the subject of an enforcement process.

70. Under paragraph 2, the right of the higher-ranking secured creditor to take over the enforcement process includes the right to enforce by any of the methods provided in this chapter. This means that the higher-ranking secured creditor may elect to pursue a different enforcement right than that contemplated by the original enforcing creditor. It should be noted, however, that the exercise of this right is subject to the standard in article 4. Accordingly, the secured creditor is obliged to act in good faith and in a commercially reasonable manner, so that it should, for example, avoid incurring unreasonable additional enforcement costs.

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

71. Article 77 is based on recommendations 146 and 147 of the Secured Transactions Guide (see chap. VIII, paras. 37-48 and 51-56) and applies only to tangible assets, as only tangible assets may be the subject of possession (for the definitions of the terms “tangible asset” and “possession”, see art. 2, subparas. (ll) and (z)). Paragraph 1 provides a secured creditor with two options for obtaining possession of a tangible encumbered asset. First, the secured creditor may obtain possession of an encumbered asset by application to a court or other authority. Alternatively, the secured creditor may obtain possession extra-judicially, provided that the conditions set out in paragraphs 2 and 3 are satisfied. Regardless of whether it proceeds judicially or extra-judicially, the secured creditor’s right to possession under paragraph 1 is subordinate to the right of a person that has a superior right to possession (e.g. a lessee or licensee whose rights are not affected by a security right under art. 34, para. 3, or para. 5).

72. Under paragraph 2, the secured creditor’s right to obtain possession extra-judicially is available only if all the conditions set out in that paragraph are met. These conditions are designed to protect the public interest in a peaceful enforcement process and to ensure that that the interests of the grantor or other person in possession are not unduly prejudiced. First, the grantor must have consented in writing to the secured creditor obtaining possession without resort to a court or other authority (typically, the secured creditor will obtain the grantor’s consent in the security agreement). Second, the secured creditor must give the grantor and any person in possession of the encumbered asset notice of default and of the secured creditor’s intent to obtain possession (the enacting State may wish to specify how much advance notice must be given and select a period that would be in line with the good faith and commercial reasonableness standard in art. 4). Third, and perhaps most important, the person in possession of the encumbered asset at the relevant time must not object to the secured creditor obtaining possession. Thus, the secured creditor must obtain the assistance of a court or other authority if the person in possession objects, even if that person is the grantor and even if the grantor has previously agreed to allow the secured creditor to obtain possession extra-judicially.

73. It should be noted, however, that a secured creditor is usually entitled to be reimbursed for its reasonable enforcements costs from the proceeds realized from a disposition of the encumbered asset. It follows that, as a practical matter, the person in possession is unlikely to raise unfounded objections if that person is the debtor or the grantor (as an unfounded objection will amount in effect to a breach of the credit or security agreement). If instead the person in the possession is a third party, an unfounded objection is also unlikely to be made since this may expose that person to liability to pay the additional costs incurred by the secured creditor in having to seek judicial assistance.

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

75. Under paragraph 4, a lower-ranking secured creditor is not entitled to obtain possession of an encumbered asset that is in the possession of a higher-ranking secured creditor, unless otherwise agreed. The purpose of this provision is to ensure that the security right of a higher-ranking secured creditor that was made effective against third parties by possession does not cease to be effective against third parties and thus does not lose its priority status through the relinquishing of possession to the lower-ranking secured creditor. It should be noted that the lower-ranking secured creditor may exercise its right to dispose of the encumbered asset under article 78 without obtaining possession, for example, by selling it extra-judicially. The buyer in this situation will acquire its rights subject to the right of the higher-ranking secured creditor, but, as a practical matter, could obtain possession only by paying off the higher-ranking secured creditor (see art. 81). If the lower-ranking secured creditor instead exercises its disposition right judicially, the security right of the higher-ranking secured creditor will be extinguished, meaning that the buyer will be entitled to obtain possession. However, the higher-ranking secured creditor will be entitled to priority of payment out of the proceeds of the disposition (see art. 79). It follows that the lower-ranking creditor is unlikely to initiate judicially-supervised disposition proceedings unless the proceeds to be realised from the disposition of the encumbered asset are likely to be sufficient to satisfy both its claim and the amount owed to the higher-ranking secured creditor.

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

76. Article 78 is based on recommendations 148-151 of the Secured Transactions Guide (see chap. VIII, paras. 48 and 57-60). Paragraph 1 provides that the secured creditor may sell or otherwise dispose of, lease, or license an encumbered asset judicially or extra-judicially. Paragraph 2 provides that, if the secured creditor elects the former option it must act in accordance with the rules specified by the enacting State that determine the method, manner, time, place and other aspects of the sale or other disposition, lease or licence.

77. Paragraphs 3-8 deal with extrajudicial dispositions by the secured creditor. Under paragraph 3 provided that its actions are in conformity with the overarching obligation to act in good faith and in a commercially reasonable manner (see art. 4), the secured creditor is entitled to determine all aspects of the sale or other disposition, lease or licence, including: (a) the method, manner, time and place; and (b) whether to sell or otherwise dispose of, lease or license the encumbered assets individually, in groups or all together (see Secured Transactions Guide, chap. VIII, paras. 71-73).

78. Under paragraph 4, the secured creditor must give advance written notice of its intention to dispose of the encumbered assets extra-judicially to the grantor, the debtor, any person with a right in the encumbered asset that notifies the secured creditor in writing of those rights, any other secured creditor that registered a notice in the Registry and any other secured creditor in possession (see paras. 4 (a)-(d)). In the case of other persons with rights in the encumbered asset that notified the enforcing secured creditor of their rights or secured creditors that registered a notice in the Registry (see paras. 4 (b) and (c)), the enforcing secured creditor has to give notice to them at least a short period of time specified by the enacting State before the notice is sent to the grantor (e.g. one to five days to allow those other secured creditors to exercise their rights, for example to take over enforcement under article 76).

79. Paragraph 5 sets out the specific information that must be included in the notice and requires the enacting State to specify the period of advance notice

(e.g. ten to fifteen days to give the grantor sufficient time to consider the proposal). Paragraph 6 requires the notice to be in a language that is reasonably expected to inform the recipient about its content and paragraph 7 provides that the language of the security agreement is sufficient to meet this standard.

80. Under paragraph 8, the notice need not be given if the encumbered asset is perishable, may decline in value speedily, or is of a kind sold on a recognized market. “Recognized market” in this context means an organized market in which large volumes of similar assets are bought and sold between many different sellers and buyers, and accordingly one in which prices are set by the market and not negotiated between individual sellers and buyers. For example, a recognized market would include a stock exchange through which shares of publicly listed companies may be bought and sold at publicly-quoted prices. In contrast, shares in a privately held company are usually bought and sold in discrete transactions on the basis of individual negotiations between seller and buyer, and would not fall within the exception.

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

81. Article 79 is based on recommendations 152-155 of the Secured Transactions Guide (see chap. VIII, paras. 60-64). It addresses the distribution of the proceeds of a sale or other disposition, lease or licence under article 78. If the secured creditor initiated the disposition by application to a court or other authority, paragraph 1 provides that distribution of the proceeds is determined by rules that must be specified by the enacting State, but the distribution must be in accordance with the priority rules of the Model Law. This requirement should be read in light of article 81, paragraph 1, which requires the enacting State to specify whether or not a buyer or other transferee in the context of a judicially-supervised disposition acquires the grantor’s right in the encumbered asset free of any other rights. Considering that paragraph 1 of this article requires secured creditors to be paid from the proceeds of a court-supervised disposition in their order of priority, it follows that the enacting State should specify in article 81, paragraph 1, that the transferee takes free of all security rights in the encumbered asset, including security rights having priority over the security right of the enforcing creditor (see para. 90 below).

82. Paragraph 2 addresses, the distribution of the proceeds of an extrajudicial sale or other disposition, lease or licence that is carried out by a secured creditor. Under paragraph 2 (a), the enforcing secured creditor is entitled to apply the proceeds in satisfaction of the obligation secured by its security right after first reimbursing itself for its reasonable costs of enforcement. Under paragraph 2 (b), any surplus must be paid to subordinate competing claimants that have notified the enforcing secured creditor of their claims, with any remaining balance then paid to the grantor. This is so because the rights of subordinate competing claimants in the encumbered asset are extinguished under article 81, paragraph 3. Alternatively, in order to relieve the enforcing creditor of having to determine the order of priority of competing claimants, paragraph 2 (c) entitles the enforcing secured creditor to pay the surplus to the judicial or other authority or fund specified by the enacting State for distribution in accordance with the provisions of the Model Law on priority. It should be emphasized that paragraph 2 (c) does not entitle higher-ranking creditors to payment from the proceeds. This is because, under article 81, paragraphs 3 and 4, the security right of a higher-ranking secured creditor is not extinguished by an extrajudicial disposition made by a lower-ranking secured creditor.

83. If the net proceeds of disposition are insufficient to satisfy the obligation secured by the security right of the enforcing secured creditor, paragraph 3 confirms that the debtor remains personally obliged to pay the deficiency. The Model Law does not address the question of whether the debtor’s obligation may be reduced or extinguished if the secured creditor failed to comply with the provisions of this chapter governing dispositions or failed to exercise its post-default rights in good

faith and in a commercially reasonable manner. Whether the debtor has a claim or counter-claim in these circumstances is a matter left to other law of the enacting State, including in particular its consumer protection law.

84. It should be noted that, in order for the provisions of paragraphs 2 and 3 to operate as intended, the secured creditor will need to provide an accounting of the disposition, specifying the amount of proceeds realized, how they were distributed and the amount of any surplus or deficiency.

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

85. Article 80 is based on recommendations 156-159 of the Secured Transactions Guide (see chap. VIII, paras. 65-70). It applies to the enforcement of a security right in both tangible and intangible assets. Paragraph 1 entitles a secured creditor to make a proposal in writing to acquire one or more of the encumbered assets in total or partial satisfaction of the obligation secured by its security right. Under paragraph 2, the secured creditor must send the proposal to the same categories of persons to whom advance notice of an intended extrajudicial disposition must be sent under article 78, paragraph 4 (see para. 78 above). In the case of other persons with rights in the encumbered asset that notified the enforcing secured creditor of their rights or secured creditors that registered a notice in the Registry (see paras. 2 (b) and (c)), the enforcing secured creditor has to give notice to those other secured creditors at least a short period of time specified by the enacting State (e.g. one to five days to allow those persons to exercise their rights before the proposal is sent) before the proposal is sent to the grantor.

86. Paragraph 3 sets out the required content of the proposal. Whether a proposal that contains erroneous information or omits required information would result in the secured creditor failing to acquire the encumbered asset would depend, by analogy to article 81, paragraph 5, on whether the error or omission materially prejudiced the rights of the persons entitled to receive the proposal (e.g. a substantial misstatement of the amount of the secured obligation would typically be viewed as resulting in material prejudice).

87. In the case of a proposal for the acquisition of an encumbered asset in full satisfaction of the secured obligation, paragraph 4 provides that the secured creditor acquires the encumbered asset so long as none of the persons to whom the proposal must be sent under paragraph 2 objects before the expiry of the period specified by the enacting State after they receive the proposal (e.g. 10 to 15 days to allow sufficient time for the addressees of the proposal to consider whether they should object, although acquisition of the encumbered asset by the secured creditor would result in full satisfaction of the secured obligation and thus in their full discharge). If a timely objection is made, the secured creditor may not proceed further and may only enforce its security right by disposition under article 78 (or collection under art. 82 where the encumbered asset is a right to payment).

88. In the case of a proposal for the acquisition of an encumbered asset in partial satisfaction of the secured obligation, paragraph 5 provides that the secured creditor acquires the encumbered asset only if all of the persons to whom the proposal must be sent under paragraph 2 positively consent before the expiry of the period specified by the enacting State after they receive the proposal (e.g. 45 days to allow sufficient time for the addressees of the proposal to consider whether they should accept although the acquisition of the asset by the secured creditor would result only in partial satisfaction of the secured obligation and thus they would remain personally liable for the balance). The requirement of positive consent in this paragraph is intended to protect the debtor, since, as the secured obligation is only partially satisfied, it would remain liable for the balance of the obligation. It is also to protect any subordinate claimant whose rights would be extinguished under article 81 paragraph 3 (see para. 91 below). As in the case of an unsuccessful proposal under paragraph 3, if the secured creditor does not obtain positive consent,

it may only enforce its security right by disposition under article 78 (or collection if the encumbered asset is one of the rights to payment set out in art. 82).

89. Paragraph 6 entitles the grantor to request the secured creditor to make a proposal under paragraph 1. If the secured creditor agrees, paragraphs 1-5 apply in the same manner as if the secured creditor had been the one to initiate the proposal process. In other words, this provision is merely facilitative in nature since the formal proposal process remains the same even where it is initially triggered by a request from the grantor to the secured creditor.

Article 81. Rights acquired in an encumbered asset

90. Article 81 is based on recommendations 160-163 of the Secured Transactions Guide (see chap. VIII, paras. 74-81). It addresses the rights acquired by a buyer or other transferee, or a lessee or licensee, pursuant to a disposition under article 78. Paragraphs 1 and 2 address judicially-supervised dispositions and require the enacting State to specify: (a) in the case of a sale or other transfer, whether or not the transferee acquires the encumbered asset free of any rights; and (b) in the case of a lease or licence, whether or not the lessee or licensee remains entitled to use the encumbered asset during the term of the lease or licence. As already noted (see para. 81 above), article 79, paragraph 1, requires the distribution of the proceeds of a judicially-supervised sale or other disposition, lease or licence to be made in accordance with the priority rules of the Model Law. This requirement means that all secured creditors are entitled to share in the proceeds in order of priority. It follows that the enacting State should specify in paragraphs 1 and 2 that a buyer or other transferee acquires the encumbered asset free of, and a lessee or licensee is entitled to the benefit of the lease or licence unaffected by, any security rights (including security rights ranking higher in priority to that of the enforcing secured creditor).

91. Paragraphs 3 and 4 take a different approach in the case of an extrajudicial sale or other disposition, lease or licence of an encumbered asset. Under paragraph 3, a buyer or other transferee acquires the grantor's right in the encumbered asset free of the security right of the enforcing creditor and the rights of any subordinate competing claimants, but subject to the rights of secured creditors that have priority over the rights of the enforcing secured creditor. The enacting State may wish to consider providing that the rule in article 81, paragraph 3, applies also in the case of the acquisition of an encumbered asset by the secured creditor (see Secured Transactions Guide, rec. 161, second sentence).

92. Paragraph 4 similarly provides that a lessee or licensee is entitled to the benefit of the lease or licence during its term except as against creditors that have priority over the rights of the enforcing creditor. The reason for the difference in approach is that higher-ranking secured creditors are not entitled to share in the proceeds of an extrajudicial enforcement initiated by a subordinate creditor (see art. 79, para. 2, and para. 82 above). It follows that a buyer or other transferee will discount the price it is willing to pay for the encumbered asset by the value of any prior-ranking security rights and a lessee or licensee will discount the amount of the rental payments it is willing to pay to address the risk that its right of use may be disrupted if the higher-ranking secured creditor elects to enforce its security right.

93. Paragraph 5 provides that the rights acquired by a buyer or other transferee, or a lessee or licensee under paragraphs 3 and 4 of this article are affected by the enforcing creditor's failure to comply with the requirements of this chapter only if two conditions are satisfied. First, they must have had knowledge of the violation, and second, the breach must have materially prejudiced their rights.

B. Asset-specific rules

Article 82. Collection of payment

94. Article 82 is based on recommendations 169-171, 173 and 175 of the Secured Transactions Guide (see chap. VIII, paras. 93-98, 102-108, 111 and 112). It provides secured creditors with an additional enforcement right where the encumbered asset is a receivable, negotiable instrument, right to payment of funds credited to a bank account or non-intermediated security. Paragraph 1 entitles the secured creditor to collect payment directly from the relevant obligor after default, as an alternative to selling or otherwise disposing of the encumbered asset under article 78. Under paragraph 2, with the agreement of the grantor, the secured creditor may exercise its right to collect even before default. Under paragraph 3, a secured creditor that collects under paragraph 1 or 2 has the benefit of any personal or property right that secures or supports payment of the encumbered asset (such as a guarantee or a stand-by letter of credit; see art. 14).

95. Paragraph 4 limits the secured creditor's right of collection if the encumbered asset is a right to payment of funds credited to a bank account and the security right was made effective against third parties solely by registration. In this situation, the secured creditor is entitled to collect (or otherwise enforce, for example, through a sale under art. 78 or through a proposal under art. 80) only if it obtains a court order or the deposit-taking institution consents. Paragraph 4 does not limit a secured creditor's right of collection where its security right was made effective against third parties by a method other than registration; that is: (a) automatically by the security right being created in favour of the deposit-taking institution itself; (b) by the conclusion of a control agreement between the deposit-taking institution, the grantor (account holder) and the secured creditor; or (c) by the secured creditor becoming the account holder, a method that requires the consent of the institution (see art. 25). The objective of this approach is to exempt deposit-taking institutions from having to respond to a request for payment sent by a person that asserts to have a security right in a right to payment of funds credited to the grantor's account unless the institution has actively consented to the creation of that security right (see Secured Transactions Guide, chap. VIII, para. 107).

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

96. Article 83 is based on recommendations 167-168 of the Secured Transactions Guide (see chap. VIII, paras. 99-101). It provides that, in the case of an outright transfer of a receivable, the transferee is entitled to collect the receivable at any time provided that payment has become due. It should be noted that the overarching obligation of good faith and commercial reasonableness in article 4 also extends to the collection of receivables by an outright transferee. As a practical matter, where the receivable is transferred outright without recourse, the transferor cannot by definition be prejudiced by the failure of the transferee to act in good faith and in a commercially reasonable manner in exercising its collection right. However, the standard in article 4 is a general one and would still apply to protect the obligor on the receivable as well as a prior-ranking creditor even in the case of an outright transfer without recourse.