ASSET SECURITIZATION IN NIGERIA: LEGAL CHALLENGES AND PROSPECTS

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Dedication

Praise be to Allah the Beneficent, the Merciful!

To my darling wife, ***Habibat Oghale***, my sweetheart in name and indeed, for the love, cares, endurance and encouragement!

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Abbreviations

ABS	Asset-Backed Securities
ABS CDS	Asset - Backed Securities Credit Default Swap
AMCON	Asset Management Corporation of Nigeria
CAMA	Companies and Allied Maters Act
CBN	Central Bank of Nigeria
CDO	Collateralized Debt Obligations
CMBS	Commercial Mortgage Backed Securitization
CRO	Credit Ratings Organization
EBRD	European Bank for Reconstruction and Development
EFCC	Economic Financial Crime Commission
IFC	International Finance Corporation
ISA	Investment and Securities Act
LFN:	Laws of the Federation of Nigeria
LPO	Local Purchasing Order
LSMP	Lagos State Mortgage and Property Law
LUA	Land Use Act
MBS	Mortgage-Backed Securities
MSME	Micro, Small and Medium Enterprises
OAS	Organization of American States
PCL	Property and Conveyancing Law
PPSA	Personal Property Security Act
PSMI	Purchase Money Security Interests
REIT	Real Estate Investment Trust
RMBS	Real Estate Mortgage Backed Securitization

SEC	Securities and Exchange Commission
SME	Small and Medium Enterprise
SPE	Special Purpose Entity
SPV	Special Purpose Vehicle
TLC	Transferable Loan Certificate
TLI	Transferable Loan Instrument
TPC	Transferable Participation Certificate
UCC	Uniform Commercial Code
UFTA	Uniform Fraudulent Transfer Act
US	United States
USD	United States Dollars
VAT	Value Added Tax
WBS	Whole Business Securitization

Abstract

Asset securitization is one of the new methods of financing beyond the horizon of the traditional equity and debt financing and it is still untested waters in Nigeria. This study is set against the background of possible utility of asset securitization in Nigeria and adequacy or otherwise of the existing law in structuring asset securitization given the peculiarities of the transaction. It adopted the analytical research approach involving analysis of case law and statutory provisions as well as secondary sources of law and scholarly writings by application of the power of reasoning. The study discussed and identified the areas of utility of asset securitization in Nigeria. For instance, providing access to banks funds to match their regulatory capital requirements and their financial obligations; possibility of investment in asset securitization under the National Pension Commission by its Regulation on Investment of Pension Fund Assets; the possibility of asset securitization helping in addressing the challenges in the housing sector; and possible utilization of asset securitization in facilitating access to immediate funding from the capital market to address the infrastructural problem. The study established a link between asset securitization and security interests and therefore discussed the challenges of priority and enforcement of security interests. The study found the asymmetric relationship between perfection and priority of security interests as unsatisfactory. It found that the existing rules of priority is complex, cumbersome and is not conducive to emergence of asset securitization. The study also discussed enforcement of mortgages and charges, the security interests found by the study to be relevant to asset securitization. The various challenges of enforcement of security interests like abuse of interlocutory injunctions and preliminary objections, recourse to court even in self-help remedies, undue delay and cost of enforcement, complex and cumbersome procedure for foreclosure and issue of agency of receiver/managers were highlighted and discussed. The relevant provisions of the Lagos State Mortgage and Property Law were also considered and while the study was critical of some of its provisions, it recommended some of it for adoption by other states. The legal frameworks for structuring asset securitization under the existing law were discussed as well as the challenges and risks attendant to asset securitization such as transfer of asset risk; re-characterization risk; insolvency/claw back risk; and risk of the underlying security. The possible legal and contractual means of mitigating the legal risks were discussed but were found unsatisfactory. The study therefore advocated the need for specific legal and regulatory frameworks on asset securitization as well as reform of the law on priority and enforcement of security interests. In addition, having found that enacting a law on asset securitization had to contend with the federal nature of the Nigerian Constitution given that different aspects of law applicable to asset securitization straddle legislative competence of both the federal and state legislature, the study advocated that asset securitization be made a distinct legislative item within the competence of the federal legislature.

Keywords- Securitization- Asset Securitization- Asset-backed Securities- Mortgage-backed Securities- Security Interests- Special Purpose Vehicles- Credit Rating Agencies- Legal Risks- Federalism

Chapter One

General Introduction

1.1 Background to the Study

Carrying out economic activities by individuals, governments and corporate bodies requires finance. According to Smith,[1] "commerce and investment are the lifeblood of any economy and financing these major economic activities requires the use of credit facilities by individual entrepreneurs, corporate entities, small and large-scale industries and multinationals".

In traditional corporate finance, there are three basic ways by which a company finances its operations: share issues,[2] debt and retained profits.[3] Raising finance through debt may be by way of direct financing where the company raises capital by issuing debt securities to investors through the capital market[4] or indirect financing where the debt finance is raised through bank loan.[5]

1 I O Smith, *Nigerian Law of Secured Credit* (Ecowatch Publications Limited, Lagos, 2001) 1.

2 Generally referred to as equity.

3 E Ferrain, *Company Law and Corporate Finance* (Oxford University Press, Oxford, 1999) 44. See also, T Burns, 'Developing a Franschise; Could Securitisation be a Serious Funding Option for Franchisors in the United Kingdom? (2006) JBL 656 at 663 where Burns states that the traditional sources of funding "included the utilisation of retained profits, the use of the proceeds from new share issues and the recourse to borrowing from the banks and other lenders". Each of these three funding options has its advantages and disadvantages which have to be considered by the relevant decision-making bodies in deciding which funding alternative to pursue at any point in time. For instance, resort to issue of new shares, that is equity finance, may lead to dilution of shareholding and hence control by the existing shareholders and issue of new shares may even send wrong signals to the market about the prospects of the business- E F Brigham, *Fundamentals of Financial Management* (6th edn, Dryden Florida Press, Florida,1992) 477. See pages 538-539 for a full list of advantages and disadvantages of equity finance. On the other hand, there may be a major advantage in resorting to debt financing in that debt finance can lower the cost of capital in terms of the impact on earnings per share- See, T. Burns, ibid, at 663-664. Ferrain also points out that there may be significant benefits, from corporate governance perspective, of adding debt to a company's capital profile in that debt may serve as a mechanism to control and monitor management as well as serve as a signal of managerial confidence. E Ferrain, ibid 62-63.

4 There are many types of debt instrument that companies use to raise funds from the capital market and the terminology used to describe debt instruments tends to be driven more by market practice than by legal definition and is thus liable to change from market to market and from time to time in response to practical developments- E. Ferrain, (n 3) 50.

5 ibid.

Development in international financial markets has thrown up new methods of financing beyond the horizon of the traditional equity and debt financing. Asset securitization, which is the focus of this study, is one of such methods of financing. Other methods of financing and credit restructuring include, trust, factoring, discounting, novation, loan selling, participation, sub-participation and swaps.

A distinction should immediately be made between asset securitization and securitization in the literal sense. Generally, securitization implies "every such process that converts a financial relation into a transaction, more specifically, into a capital market instrument."[6] It has also been described as "a process of converting something into a security." Security in this context is a capital market instrument.[7] In this literal context, securitization is the "monetisation of assets, a mechanism which converts an illiquid monetary obligation into a marketable security instrument."[8] Thus, securitization will encompass debenture, bonds, notes and other debt instruments that are cognisable and regulated under the Investment and Securities Act[9] and applicable provisions of Companies and Allied Matters Act, 1990.[10] However, it is asset securitization and not securitization in the literal sense that is contemplated in this study.

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6 V Kothari, *Securitisation, Asset Reconstruction and Enforcement of Security Interests* (2nd edn, Wadhwa and Company, New Delhi, 2007) 5. Kothari gives example of the packaging of the ownership of a company which is a relation as a transaction by the creation of ordinary share and according to the commentator this is an "earliest instance of securitization" and that the present day concept of securitization still draws upon the concept of equity share.

7 ibid 6.

8 S A Naik, *Law of Securitisation & Enforcement of Security Interest*, (1st edn, LexisNexis Butterworths, Wadhwa Nagpur, 2008) 5.

9 Cap I24 Laws of the Federation of Nigeria, 2010.

10 Cap C20 Laws of the Federation of Nigeria, 2010.

Asset securitization, in the context of this study, is "a process by which an entity pools together its interest in identifiable future cash flows, transfers the claims on those cash flows to another entity specifically created for the sole purpose of holding those financial claims and then utilises those future cash flows to pay off investors over time, either with or without credit support from a source other than the cash flows."[11]

Descriptively, the structure of a basic asset securitization transaction is that an enterprise (be it bank, corporate or other), known as the originator, sells a pool of assets, (such as loans, mortgages, leases, consumer receivables), to a special purpose vehicle, (SPV), established for the transaction or an existing SPV. The sale may be by way of assignment or similar transfer technique and the SPV is usually an orphan company, (its shares being held on trust for charitable purposes), rather than a company in the originator's group. The SPV raises funds with which to purchase the assets by issuing bonds or other forms of securities in the capital market. The SPV then contracts with another party, usually the originator, for the administration (servicing) of the assets. Income and principal arising from the assets are applied in paying interest and principal on the bonds or other securities such that payments to investors depend on the performance of the assets in the pool purchased by the SPV rather than on the credit of the originator. Any surplus is returned to the originator.[12]

The end product of asset securitization is the creation of asset-backed securities (ABS) which must be distinguished from securities in the usual capital market instruments. The distinction

[11] F J Fabozzi and V Kothari 'Securitization: The Tool of Financial Transformation' available at http://ssrn.com/abstract=997079 last visited on Tuesday 20th day of April, 2010. See also, V Kothari, (n 6) 6, A Jobst, 'What is Securitisation?' F & D, September 2008, Vol. 55, No. 3, 48 and J V Robbe, *Securitisation Law and Practice in the Face of the Credit Crunch* (Wolters Kluwer, Austin, 2008) 3.

[12] E Cresswell and M Raines, 'European Securitisation Undergoes Transition' (2002) 22 Euro. Law. 46 at 48.

lies in the fact that whereas a usual capital market instrument is an exposure in the business of the issuer, an ABS is simply an exposure in an asset, or a bunch of assets.[13] Also, an ABS is not a claim on an entity but a claim on a pool of assets.[14]

Even though in the United States of America (US), distinction is made between mortgage backed securities, that is, where the receivables securitized are supported by mortgage security and ABS where the receivables are not supported by mortgage security,[15] in practical terms, ABS typically includes all kinds of receivables including mortgage-backed receivables.[16] Therefore, in this study, ABS when used includes mortgage-backed securities. Apart from mortgage-backed securities, other common assets under the generic term ABS, include credit card receivables, auto loan, equipment loan and consumer loan receivables, trade receivables, and lease receivables.[17]

1.2 Significance of this Study

The motivation for this research is brought about by a number of reasons. First, there is the recent experience in the Nigerian banking sector where some banks had huge amount of receivables and yet became technically insolvent because they lack immediate funds to meet their regulatory capital requirements and their financial obligations. Second, it is found that the National Pension Commission by its Regulation on Investment of Pension Fund Assets,

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13 V Kothari (n 6) 7.
14 F J Fabozzi and V Kothari (n 11).
15 V Kothari (n 6) 11.
16 V Kothari (n 6) 11.
17 J V Robbe (n 11) 7.

2012[18] recognised that pension fund assets may be invested in investments that are structured as a securitised transaction.[19] Yet, there is absence of asset securitization in Nigeria.

Third, asset securitization may, going by the experience of the US, help in addressing the challenges in the housing sector. The development of modern asset securitization in the US developed as part of the conscious effort by the US government to facilitate home ownership. Fourth, Nigeria is faced with the problem of provision of adequate infrastructure. It is felt that utilization of asset securitization may facilitate access to immediate funding from the capital market with a view to solving the infrastructural problem.[20] Fifth, the passage of the Asset Management Corporation of Nigeria (AMCON) Act, with the taking over of some of the receivables of the banks, has also opened a vista for possible promotion of asset securitization in Nigeria. Lastly, considering the interconnectedness of market in the now globalized world, it is a matter of time that circumstances may impel the introduction of asset securitization in Nigeria.

In view of the foregoing, it is felt that it is a relevant field of inquiry to consider the issue of promotion of asset securitization in Nigeria and in particular, the challenges and prospects of legal aspects of its introduction and utilization in Nigeria.

[18] Available at http://www.pencom.gov.ng/docs/1448884100_Regulation_on_Investment_of_Pension_Assets_2012.pdf; last visited on 6th December, 2015.

[19] Paragraph 4.3 of the Regulation on Investment of Pension Assets provides that pension fund shall be invested, among others, in "Asset Backed Securities including Mortgage Backed Securities."

[20] See J Tucker and I Harvey-Samuel, 'Securitization in the Project Finance and Infrastructure Arena' in J J de Vries Robbe and P Alli (eds), *Expansion and Diversification in Securitisation Yearbook 2007* (Kluwer Law International, The Netherlands, 2008) 143.

1.3 Statement of the Problem

In Nigeria, the use of asset securitization as a means of financing is untested waters notwithstanding that other developing economies, like South Africa, have embraced it. Asset securitization is a distinct financing transaction with its peculiar legal and regulatory considerations. Asset securitization is described as the creation of ABS, that is, debt instruments secured against specific assets or against specific cash flows or receivables whereby the creation of the ABS is effected by a company first selling the assets or the specific cash flows (receivables) to an SPV, who then issues bonds or other debt instruments and use the money raised from the issue to pay the company for the assets.

In order to properly situate the problem, it is relevant to first set out the structure of a typical asset securitization, that is:

1. A pool of income yielding assets of the originators are pooled together;
2. SPV is set up or an existing SPV may be used;
3. The pool of income yielding assets are transferred to the SPV;
4. Where there is security interests underlying the pool of income yielding assets, the security interests are also transferred to the SPV;
5. The SPV issues ABS in the capital market to investors; and
6. The SPV uses the proceeds from the income yielding assets to repay the investors in the ABS.

From the structure of asset securitization, an immediate observation is that to effect asset securitization there will be recourse, as is explained here, to different multiple legal provisions to structure the different aspects of asset securitization. Where the income yielding assets are land-based, the transfer of the income yielding assets to the SPV and its underlying security interests will be effected using property law legislations which are within the legislative competence of the state legislatures as well as the rules of common law and equity relating to transfer of proprietary and security interests. On the other hand, the establishment of the SPV and the issuance of asset-backed securities will be effected by corporate and securities laws which are within the legislative competence of the federal government. Therefore, the applicable legal provisions to asset securitization straddle legislative competence of state and federal legislatures. The problematic implications of this will be examined below.

The applicability of different laws in itself does not constitute problem; the real problem is that these potentially applicable legal provisions were fashioned out as general property and corporate law provisions not specifically tailored for asset securitization. Asset securitization has its peculiarities like bankruptcy remoteness of the SPV, effective non-recourse transfer of asset to the SPV, true sale characterization of transfer of asset to the SPV and effectiveness of the underlying security and its transfer to the SPV. There is, therefore, the problem of adequacy of the extant statutory regime to structure asset securitization given the peculiar requirements of the transaction.

Flowing from the problem of adequacy of the existing potentially applicable law is the problem of legal risks attendant to asset securitization using the infrastructure of the existing law and the extent that these legal risks can be mitigated using contractual and due diligence mechanisms.

Also, the applicable legal provisions to asset securitization straddle legislative competence of federal and state legislatures, therefore there is the problem of determining, as between the federal and state legislatures, the issue of legislative competence to make laws to provide for and regulate asset securitization. This may arise in the context of legislative reform to make an all-encompassing legislation to address the problem of legal risks and challenges in asset securitization under the existing law as has been done in some other countries like France, Germany and Belgium. Therefore, there is the problem of constitutional competence to make necessary legislative reform on asset securitization.

As can be seen from the description of asset securitization, the realization of the income from the asset transferred to the SPV is crucial to achievement of the goal of asset securitization because that is ultimately what will be used to repay the investors in ABS. In many instances, there will be transfer of security interests underlining the asset transferred to ensure realization of the income from the transferred assets. Therefore, the efficacy of the security interests system in the country becomes a crucial factor in promoting asset securitization. The problem in this regard is that of adequacy of the existing legal framework for security interests, particularly priority and enforcement of security interests, to support asset securitization. It is important to address this problem because security interests still remain important in the context of asset securitization due to its role in mitigating credit risk and its ability to carve up assets for the benefit of investors and other creditors.[21]

1.4 Aims and Objectives

The aims and objectives of this research work are:

1. Examining the relevance and justification of promotion of asset securitization in Nigeria;
2. Examining the relationship between asset securitization and security interests and considering the adequacy or otherwise of security interests law in Nigeria;
3. Examining the existing legal provisions on asset securitization and the legal risks and challenges attendant to structuring asset securitization under the existing law;
4. Examining the constitutional competence to make law on asset securitization in Nigeria; and
5. Proposing reform of the existing legal frameworks for security interests to facilitate asset securitization and new legal frameworks for asset securitization in Nigeria.

1.5 Operational Definition of Terms

The following important terms in the title of the study bear the following meaning in the context of this work:

1.5.1 Asset Securitization- The creation of ABS, that is, debt instruments secured against specific assets or against specific cash flows or receivables which creation is effected by a company first selling the assets or the specific cash flows (receivables) to a

[21] See P U Alli, *Secured Finance Transactions: Key Assets and Emerging Markets* (Globe Law and Business, London, 2007) 5-7.

special purpose vehicle, (SPV), who then issues bonds or other debt instruments and uses the money raised from the issue to pay the company for the assets.

1.5.2 **Assets/Receivables-** This means debt or contractual right to payment of a monetary sum.

1.5.3 **Originator-** This is the company or entity that initiates and engages in asset securitization transaction.

1.5.4 **Special Purpose Vehicle (SPV/SPE)-** This is the company or the entity created for the purpose of asset securitization transaction and to whom the assets/receivables are transferred by the originator and which then issues debt securities or debt instruments to the investors/bondholders.

1.5.5 **Investors/bondholders-** These are members of the public who purchased the debt securities or debt instruments.

1.5.6 **Asset-backed securities-** These are debt instruments secured against specific assets or against specific cash flows or receivables**.**

1.5.7 **Legal Risks-** Risks of a legal nature that may affect the validity of and/or attainment of the goals and objectives of asset securitization transaction

1.5.8 **Credit Rating Agencies-** These are the bodies that examine and assign credit rating to an asset securitization deal.

1.5.9 **Credit Enhancement-** These are the mechanisms adopted to protect investors in securitised assets against loss or shortfall in the value of the asset.

1.5.10 **Federalism-** This is a system of government whereby there is division or allocation of legislative and executive powers between two tiers of government.

1.5.11 Security- This is the mechanism by which lenders seek to protect themselves against the risk of payment default by the borrower.

1.5.12 Security Interests- This is a right given to one party in the asset of another party to secure payment or performance by that other party or by a third party.

1.6 Scope and Delimitation of Study

This study focuses on the relevance and justification for evolution of asset securitization transaction in Nigeria. It examines the existing legal and constitutional frameworks relevant to asset securitization as well as legal risks of asset securitization under the existing law. It also examines the relationship between security interests and asset securitization and the importance of adequate security interests' law to asset securitization. In this connection, the study identifies areas of inadequacies of existing security interests' law in Nigeria and proffers suggestions for reform. Further, the study identifies legal risks and challenges to asset securitization using the infrastructure of the existing law and proposes a new legal regime specifically targeted at asset securitization in Nigeria.

Whereas there are different kinds of securitization with each having different levels of sophistications, this study focuses on what is generally referred to as asset securitization. The study is primarily about legal aspects of effecting asset securitization and is, therefore, not concerned about tax, accounting and financial issues in asset securitization.

1.7. Research Questions

The main research questions that this study seeks to answer are as follows:

1. What are rationale for and benefits of promoting asset securitization in Nigeria?

2. What is the relationship between asset securitization and security interests and how adequate is the existing security interests system in Nigeria to support asset securitization?
3. What are the existing legal provisions on asset securitization and the legal risks as well as challenges attendant to structuring asset securitization under the existing law?
4. Is it the federal or the state legislature that has the legislative competence to make reform legislation on asset securitization?

1.8 Theoretical Framework

1.8.1 Theoretical Justification for Asset Securitization

The rationale for the use and practice of asset securitization as well as its legality and efficiency has not been free from theoretical disputations. On the one side are writers who belong to what is described here as the anti-securitization school of thought. These writers are critical of the utility of asset securitization and in fact questioned its legitimacy.[22]

[22] See: J E Janger, 'The Death of Secured Lending' (2004) 25 Cardozo L. Rev.1759 (arguing that asset securitization is the "biggest threat to secured lending"); M Nwogugu,'Illegality of Securitisation: Bankruptcy Issues and Theories of Securitisation' (2008) 23(7) JIBLR, 363-377 (arguing that securitisation is illegal under the US law and contravenes the Bankruptcy Code); L M LoPucki, 'The Death of Liability' (1996-1997) 106 Yale L.J. 1 (arguing that securitisation is one of the techniques of judgment proofing- A debtor is judgment proof when the debtor has no wealth or holds its wealth in forms not subject to legal process for collection. That is, judgments against the debtor are uncollectible L M LoPucki, 'The Irrefutable Logic of Judgment Proofing: A Reply to Professor Schwarcz' (1999) 52(1) Stan. L. Rev., 55-71 (where the contention that securitisation has the potential of being a judgment proof technique irrespective of whether transaction was done at arm's length or not). E Kurt, 'Held Up in Due Course: Predatory Lending, Securitization, and The Holder in Due Course Doctrine'. (2002) 35 Creighton L. Rev. 503, available at SSRN: http://ssrn.com/abstract=904661 last visited on 13 September, 2010 (contending that securitization provides an opportunity and safe haven for predatory lending, and worse yet, reduces lender discretion in resolving borrowers' difficulties once the borrowers discover they are the victims of deception). C L Peterson, 'Predatory Structured Finance' (2007) 28(5) Cardozo L. Rev. 2185. Available at SSRN: http://ssrn.com/abstract=929118 last visited on 13 September, 2010 (contending that while securitisation can lower the cost of funds for lenders, allowing them to offer better prices, it can also capitalize fly-by-night companies that specialize in fraud, deceptive practices, abusive collections, and other predatory behavior).

On the other hand are writers who belong to what is described here as the pro-securitization school of thought. These writers are in favour of asset securitization and contend that there are theoretical and practical justifications for asset securitization.[23] The divergent views of these schools of thought will now be examined.

1.8.1.1 Anti-Securitization Perspectives

Janger is of the view that the biggest threat to secured lending is asset securitization. According to him, the basic structure of asset securitization is a "creative twist on secured loans".[24] While acknowledging that asset securitization has the benefits of liquidity and risk pooling, he opines that the benefits come with costs that are often overlooked. For instance, asset securitization has the risk alteration effect by shifting the risk from the investors of the assets held by the SPV to the creditors of the originator. While noting that this risk alteration is similar in nature and effect to the risk alteration caused by secured credit, he states that the effect is enhanced because asset securitization is thought to place the assets conveyed to the SPV beyond the reach of sections 541, 362 and 363 of the US Bankruptcy Code. Further, that

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[23] E M Iacobucci and R A Winter, 'Asset Securitization and Asymmetric Information' available at http://rusipoteka.ru/files/library/iacobucci-1.pdf last visited on 18th August, 2010. S J Lubben, 'Beyond True Sales: Securitisation and Chapter 11' (2004-2005) 1 N.Y.U.J.L. & Bus. 89; S L Scwarcz 'The Alchemy of Asset Securitization' SJLBF, (1994) Vol. 1, 133. Available at SSRN: http://ssrn.com/abstract=868520 last visited on 13 September, 2010; S L Scwarcz 'The Inherent Irrationality of Judgment Proofing' (1999) 52 Stan. L. Rev. 1; C A Hill, 'Securitization: A Low-Cost Sweetener For Lemons' (1996) Wash. U.L.Q. 1061; K N Klee and B C Butler, 'Asset-Backed Securitization, Special Purpose Vehicles and other Securitization Issues' (2002) Vol. 35(2) UCCLJ, available at http://ktbllp.com/publications/asset_backed_securit.pdf last visited on 13 September, 2010; and T E Plank 'The Security of Securitization and the Future of Security' (2004) 25(5) Cardozo L. Rev., 1655, available at SSRN: http://ssrn.com/abstract=1334831 last visited on 13 September, 2010; S Din, 'Understanding Securitisation in the Context of Corporate Recapitalisations and Acquisitions' (2000) 15(6) J.I.B.L. 128.

[24] According to the commentator: "Instead of entering into a secured financing, where assets are used as collateral for a loan, a company that wishes to raise money (the "Originator") sells assets to a separately organized entity-a special purpose vehicle ("SPV")--that exists solely for the purpose of buying assets from the Originator and issuing securities backed by those assets ("Asset Backed Securities" or "ABS")" J E Janger, (n 22) .

the risk alteration effect is compounded by what he called “transparency cost”.[25] Janger, therefore, submits that the source of the apparent 150 basis point advantage enjoyed by asset securitization over secured debt is generated in part by value-creating, efficiency-enhancing attributes of asset securitization transactions, and in part by the externalities created by (1) shifting risk of default to non-adjusting and non-consensual creditors of the originator, (2) concealing liens, and (3) distorting the balance sheet of the originator by taking opportunistic advantage of accounting rules to call something a sale which is really a loan. Therefore, originators of asset securitization transactions may choose to use this method of capital formation for two distinct sets of reasons, one, efficiency enhancing, and the other rooted in moral hazard.

Janger further submits that secured lending runs the risk of becoming the poor cousin of asset securitization, not because asset securitization offers greater efficiency, but because it facilitates regulatory evasions and creates economic distortions which alter risk, undercut transparency, and as a side effect, favour consolidation among both borrowers and lenders. Asset securitization, accordingly, favours large enterprises over smaller ones because, according to him, while asset securitizations may provide an interest rate advantage, they are expensive to construct, and therefore are only economic for transactions of significant size. Secondly, asset securitization favours large financial supermarkets over traditional commercial banks.[26]

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25 He points out that a source of transparency costs results from the peculiarities of the rules for off-balance sheet accounting for securitized assets.

26 See J E Janger (n 22) at 1777-8.

Nwogugu,[27] being also critical of asset securitization, submits that all “true sale”, “disguised loan” and “assignment” securitizations involve fraudulent conveyances, (as defined in the US Bankruptcy Code and the Uniform Fraudulent Transfer Act -UFTA), because the sponsor typically receives insufficient value for assets that it transfers to the SPV.[28] It is also fraudulent conveyance because such securitizations are the equivalent of illegal pre-petition waivers of the right to file bankruptcy, and the waiver of the bankruptcy stay- all of which are sufficient evidence of “intent to hinder, delay, or defraud any creditor of the debtor”, which is the major element of fraudulent conveyance under the UFTA and the US Bankruptcy Code. Furthermore, this implicit pre-petition waiver of the right to file for bankruptcy contravenes the legislative intent of the US Bankruptcy Code.

In addition, Nwogugu contends that asset securitization can increase the bankruptcy risk of an originator, where: a) the cash proceeds from the asset securitization transaction are significantly less than either the carrying value of the collateral, or the net realisable value of the collateral (liquidation value in a supervised auction); or b) management reinvests the cash proceeds of asset securitization in projects that yield returns that are less than what the collateral would have yielded or less than the company's cost of debt. Further, he submits that asset securitization undermines US federal bankruptcy policy, because it is used (in lieu of secured financing) as a means of avoiding certain bankruptcy law restrictions.[29] He further points out some theoretical postulates against asset securitization: one is what he referred to as

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27 M Nwogugu (n 22) .

28 While noting that his analysis is supported with US case law, the principles derived are applicable to securitization transactions in common-law countries and civil-law countries.

29 Nwogugu notes that the origins of securitization in the US can be traced directly to efforts by banks and financial institutions to avoid bankruptcy law restrictions. (n 22).

the "illegal wealth-transfer theory". According to this theory, asset securitization can result in illegal wealth transfers to the intermediary bank where it retains a residual interest in the Trust/SPV, (residual securities), or is over-compensated, (excessive cash fees, trustee positions, underwriter is granted a percentage of securities offered, etc.). Further, asset securitization can result in fraudulent conveyance and illegal wealth transfer where the transaction effectively renders the originator/issuer company technically insolvent; or fraudulently transfers value to the SPV (in the form of low collateral values), and then to the asset-backed securities (ABS)/mortgage-backed securities (MBS) bond holders, (in the form of low bond prices, and or high interest rates).

Another theoretical postulation by Nwogugu relates to the priority-changing effect. He submits that to the extent that bankruptcy laws are designed to facilitate rehabilitation of troubled companies, and increase efficient allocation of debtor assets to creditors, asset securitization enables the debtor to circumvent the "absolute-priority principle" and to effectively re-arrange priorities of claims, particularly where the debtor/originator does not have any secured claims but has only unsecured claims.[30] He offers another criticism of asset securitization on information-content effect. According to him, asset securitization[31] changes and distorts the perceived financial position of the originator/sponsor, because various forms of credit enhancement, (senior/junior pieces, loan insurance, etc.), are used to achieve a high credit rating for the SPV which may be misconstrued by stock market investors as evidence of good prospects for the sponsor/originator. According to the scholar, due to the fact that all

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[30] According to the writer, this is achieved by securitising un-encumbered assets and using credit enhancement to provide higher-quality securities/claims (the equivalent of higher priority) to other creditors.

[31] Especially "assignment" securitizations.

securities offerings have relevant information content and associated signalling, asset securitization by financially distressed companies effectively conveys the wrong signals to capital markets and hence changes the expectations of creditors and shareholders. Further, in the case of bankruptcy, asset securitization makes it more difficult to efficiently form consensus on a plan of reorganisation once the bankruptcy petition is filed.

There is also the joint venture explanation by the scholar as he postulates that the asset securitization of future-flows (true sale or assignment) is essentially a joint venture among the sponsor/issuer, the investment bank and ABS investors. According to him, in some circumstances, this joint venture structure and the underwriting investment bank intentionally misallocate risk among these three parties, (that is, allocation of risk relative to amount invested, horizon, credit enhancement and returns). He also points out what he called the "Central Bank displacement effect". According to him, the main monetary policy tools of most central banks are: 1) changes of interest rates on government funds lent to banks; 2) changes of the volume of funds lent by the Central Bank to banks; 3) sales and purchases of government bonds; and 4) sales and purchases of domestic and foreign currencies. The commentator, however, submits that asset securitization effectively displaces and weakens the Central Bank's monetary policy tools, primarily because the securitization process returns money to the capital markets for more lending activities and the interest rate, speed-of-return, form, magnitude and control of such "returned capital" is not primarily determined by the Central Bank.

Another postulation critical of asset securitization is that of LoPucki[32] who submits that securitizing allow firms to "judgment-proof"[33] themselves. Asset securitization offers "virtual elimination of the risk that the courts will disregard the entity that holds the assets"[34] and thus "asset securitization may be the silver bullet that kills liability".[35] The problem with LoPucki's postulation is that, as Schwarcz[36] points out, selling assets in an asset securitization transaction does not itself diminish the capital in the firm that is available to creditors. In such a deal, assets of one kind are simply exchanged for assets of another kind: in an arms-length transaction, the originator will receive proceeds equal in value to the assets sold, thus not diminishing the value of the originator's estate.

In response to Schwarcz's argument, Iacobucci and Winter[37] note that asset securitization, while not itself sufficient to judgment-proof a firm, is a useful component of a judgment-proofing technique: first securitize, then distribute the proceeds to claimants.[38] LoPucki[39] also notes that for most firms whose asset securitization transactions have been reported in the press, the plan was to pay creditors or shareholders. However, White[40] provides empirical evidence that is not generally supportive of LoPucki's theory. For example, along with the

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32 L M LoPucki, *The Death of Liability* (n 22).

33 According to LoPucki, "A debtor is judgment proof when the debtor has no wealth or holds its wealth in forms not subject to legal process for collection. That is, judgments against the debtor are uncollectible." ibid.

34 ibid, 24.

35 ibid, 30.

36 S L Schwarcz, *The Inherent Irrationality of Judgment Proofing* (n 23)

37 E M Iacobucci and R A Winter (n 23).

38 Aside this contention by Iacobucci and Winter, L M LoPucki, *The Irrefutable Logic of Judgment Proofing: A Reply to Professor Schwarcz* (n22) at 59 responds effectively to Schwarcz with an analogy: "To see the fallacy, consider by analogy the invention of a new tool that makes burglary easier. Neither the fact that the new tool has uses other than burglary nor the fact that burglaries could be accomplished without it would prove that the new tool was not a dangerous new threat to the security of homes. Asset securitization is under attack because it appears to be the most efficient, effective judgment-proofing tool currently available."

39 L M LoPucki, *The Death of Liability* (n 22).

40 J J White, 'Corporate Judgment Proofing: A Response to Lynn LoPucki's The Death of Liability' 1998 Yale L.J 106:1363 - 1412.

growth of asset securitization, there has been no downward trend in corporate asset-to-liability ratios or in the amount of liability insurance being purchased by corporations. Iacobucci and Winter[41] also conclude that while we cannot dismiss the possible use of asset securitization as a judgment-proofing technique in some cases, the explanation is not very robust.[42]

1.8.1.2 Pro-Securitization Perspectives

In contrast to the anti-securitization schools of thought, some other scholars have put forward theoretical postulations in support of asset securitization. Schwarz, for instance, submits that asset securitization is an alchemy[43] that really works. A company, in asset securitization, partly "deconstructs" itself by separating certain types of highly liquid assets from the risks generally associated with the company. The company can then use these assets to raise funds in the capital markets at a lower cost than if the company, with its associated risks, could have raised the funds directly by issuing more debt or equity. The company retains the savings generated by these lower costs, while investors in the securitized assets benefit by holding investments with lower risk.

Schwarz further submits that asset securitization is most valuable when the cost of funds, reflected in the interest rate that is necessary to entice investors to purchase the SPV's securities, is less than the cost of the originator's other direct sources of funding. The SPV's lower cost of funds is passed on to the originator through a higher selling price for the originator's receivables. The goal of asset securitization, according to Schwarz, is to obtain

41 E M Iacobucci and R A Winter (n 23).
42 ibid 170.
43 Alchemy refers to a technique whereby medieval chemists attempted to turn base metals into gold.

low cost capital market funding by separating all or a portion of an originator's receivables from the risks associated with the originator. He also points out how variations in asset securitization structures can affect direct transaction costs and flexibility, and that each structure is also associated with certain indirect costs and benefits. Finally, he submits that the indirect benefits of asset securitization will more often than not compensate for its indirect costs.

One of the most important indirect benefits is that asset securitization provides a source of off-balance sheet funding. Because asset securitization is usually viewed, for accounting purposes, as a sale of assets and not as financing, the originator does not record the transaction as a liability on its balance sheet. Such off-balance sheet funding thus raises capital without increasing the originator's leverage or debt-to-equity ratio on its financial statements. Another benefit of asset securitization is that it may represent an additional and untapped source of financing for an originator. Aside from this, certain asset securitization may also result in a lower weighted average interest rate to the originator through the use of a "senior/subordinate" securities structure at the SPV level. Sophisticated investors provide the equivalent of "credit enhancement" to the SPV by purchasing subordinated securities. Despite its transaction costs, asset securitization can be less expensive than alternative funding sources because it enables originators to obtain low cost capital market funding.

Schwarz further raises the issue of why capital markets should be prepared to fund asset securitization transactions at a lower rate than secured financing. At least one explanation is that asset securitization serves as a means of reducing “monitoring costs,” a theory originally presented by Kronman and Jackson in the secured financing arena.[44]

Schwarz opines that in asset securitization, the originator’s receivables are sold to a bankruptcy remote SPV in a “true sale” in which case, a bankruptcy of the originator would not adversely affect the ability of investors to receive payment on their ABS. Therefore, because a bankruptcy remote structure separates the source of payment of the SPV’s securities from the risks associated with the originator, the need to monitor the originator’s financial condition is largely eliminated.[45] The writer submits that asset securitization opportunities are no longer limited to the financing of receivables and that the techniques have recently been applied to inventories and other assets that do not themselves constitute rights to payment but may nonetheless give rise to such rights over time and that the potential application of asset securitization to these “future rights” is nearly limitless.

The scholar further submits that asset securitization can also be applied to project-finance transaction to help meet the current demand for infrastructure development and improvement from conception to completion. He further submits that asset securitization not only reduces an originator’s direct financing costs but also provides significant indirect benefits. Asset securitization, however, entails real costs and should only be used after comparison with

[44] Monitoring cost is a theory originally presented by Kronman and Jackson in the secured financing arena. Because the interest rate on the loan is determined when the loan is made, a borrower may take actions that increase the loan’s riskiness after the loan is made. Kronman and Jackson argue that a creditor will incur certain monitoring costs as a result to ensure that the borrower’s actions do not increase the risky nature of the loan. In this regard, a secured creditor should have lower monitoring costs than an unsecured creditor because the secured creditor needs to monitor the borrower’s actions only in regard to the collateral backing its loan and can disregard how the borrower acts generally. See, A T Kronman, and T H Jackson, ‘Secured Financing and Priorities among Creditors’ (1979) available at http://digitalcommons.law.yale.edu/fss_papers/1070 last visited on 5th December, 2015.

[45] He however noted that although the risk associated with servicing and collecting the receivables still necessitate some monitoring, these risks can be borne by providers of credit enhancement or investors in subordinated securities, parties who are in the business of precisely assessing and absorbing such risks.

alternative sources of funding. Due to the fact that asset securitization has only been applied to a portion of its potential market opportunities, it promises to be a financing technique that will continue to grow. To Schwarz, asset securitization, mainly, brings to financial technology what the sought-after alchemist's stone promised to bring to base metals - the ability to turn them into gold.

Iacobucci and Winter[46] are of the view that many of the existing theories that have theoretical validity depend on factors external to the firm, such as regulation or involuntary creditors, to explain asset securitization. According to these writers, if regulation avoidance or judgment proofing were the explanation of asset securitization, it would be appropriate to doubt its social usefulness (assuming that the regulation in question makes sense). In contrast to the other theoretical approaches, the writers submit that asset securitization represents a change in the organization of a firm, and that it is natural to base an analysis of the strategy on informational asymmetries, which provide the foundation of the theory of the firm. They, therefore, categorize theories of asset securitization according to two classes of underlying informational asymmetries: one class is the set of informational differences among investors that exist at the time that securities are issued ("hidden information," in the modern parlance of economic theory); the other class is the set of informational asymmetries between managers and investors about managerial actions and uncertain factors that affect security payoffs and that are realized during the period between security issue and the date of security maturity ("hidden action" or "agency" problems).

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[46] E M Iacobucci and R A Winter (n 23).

They submit that segregating cash flows from the rest of the firm can facilitate monitoring of managers and that asset securitization can also be useful in controlling agency problems by limiting managerial discretion over cash flows. Iacobucci and Winter develop the hidden-information perspective on asset securitization by showing that, where investors are differently informed about the values of different classes of assets within the firm, market forces compel a segregation of ownership of the asset classes, and that, this is precisely what asset securitization accomplishes. It is this that distinguishes asset securitization from secured debt, which, according to them, is often insufficient to achieve the benefits of asset securitization.

The scholars further submit that asset securitization is used to reduce agency costs. They point out that limiting future agency costs through reduction of the agency costs of free cash flow by committing the future cash intake to investors is only half the story. According to them, asset securitization not only protects future cash flows from mismanagement but also gives rise to a relatively large cash infusion for the originator. Further, that the substitution of future cash flows for a one-time cash payment adds value to the firm by facilitating monitoring and limiting the agency costs associated with that cash. The economies of scale inherent in monitoring provides an explanation of asset securitization as allowing a focus or concentration in terms of cash flows that are vulnerable to the agency costs associated with free cash flow.

While pointing out that the hidden-action explanations of asset securitization depend on the separation of cash flows that are risky but relatively insensitive to managerial effort from other cash flows,[47] Iacobucci and Winter[48] submit that the cash flow theory of asset securitization depends on the separation of cash flows from the rest of the firm to reduce agency costs, but for different reasons. According to them, partitioning off these flows in an asset securitization transaction exchanges a series of small, difficult-to-monitor cash flows for a single, relatively easy to monitor cash infusion, thus reducing the agency costs of free cash flow. The uniqueness of asset securitization and its effectiveness in addressing information problems help explain its recent explosion in popularity and thus, consideration external to the firm, such as regulation or judgment proofing, are not necessary to provide a coherent positive account of asset securitization.

1.8.1.3 Efficiency Theory of Asset Securitization

Schwarcz propounds efficiency theory of asset securitization.[49] In doing this, he submits that there must first be agreement as to the standard by which the efficiency will be measured. According to him, in law and economics literature efficiency is generally defined either by Pareto or Kaldor-Hicks efficiency. Efficiency, in Pareto sense, means that in the context of an asset securitization transaction, the transaction would make the parties to the securitization, that is the originator and the SPV's investors, better off and no other parties worse off. The only other party that may be made worse off are the originator's unsecured creditors. Therefore, asset securitization would be Pareto efficient only if they do not harm the originator's unsecured creditors. On the contrary, Kaldor-Hicks efficiency, in the context of

[47] According to the commentators, partitioning in this case helps control agency problems by reducing the risk to the firm from factors beyond managers' control.
[48] E M Iacobucci and R A Winter (n 23).
[49] S L Schwarcz, 'Securitization Post-Enron', Duke Law School Public Law and Legal Theory Research Paper Series, Research Paper No. 38, May 2003 available from http://ssrn.com/abstract=386601; last visited on 8 December, 2014.

asset securitization, means that the aggregate benefit to the parties to asset securitization exceeds any net harm to the other parties, that is, to the originator's unsecured creditors.

Schwarcz proceeds by submitting that economists generally accept Kaldor-Hicks, and not Pareto as the operating standard of efficiency and further submitted that asset securitization transactions should therefore be considered efficient if the aggregate benefit to the SPV's investors and the originator exceeds any net harm to the originator's unsecured creditors. Having demonstrated that benefits of the originator and the SPV's investor will exceed any net harm to unsecured creditors, the writer contends that any net harm to unsecured creditors is likely to be zero or negative because asset securitization transaction does not, in the aggregate, result in net harm but instead create net value for unsecured creditors. The commentator predicated his contention on the following three steps:

First, because asset securitization provides the originator with new money, unsecured creditors are not harmed absent the originator investing or otherwise using that money in a manner that reduces its value ("overinvestment"). Second, even though overinvestment sometimes occurs, it only harms unsecured creditors where the originator goes bankrupt: that harm should be more than offset by the originator's lower interest-cost burden (thereby preserving value to pay unsecured creditors) and the fact that asset securitization provided liquidity to companies that need liquidity but are unable to borrow, thereby enhancing creditor recovery. Third, both empirical evidence and the relative rarity in negative-pledge covenants restrictions on asset securitization transactions demonstrate that unsecured creditors themselves view asset securitization as providing net value.

On the issue of whether asset securitization is fair, Schwarcz submits that his analysis demonstrates that asset securitization is indeed fair to, and does not prejudice, unsecured creditors as a class. While acknowledging that individual unsecured creditors may sometimes be harmed by asset securitization, he contended that in the absence of favouritism or prejudice, fairness must be judged by reference to a class not its individual members. The scholar further submits that asset securitization does not harm non-adjusting creditors.[50] This work agrees with the submissions of Schwarcz and adopts the efficiency theory of securitization.

Asset securitization, according to Peicuti,[51] combines three major characteristics and these explain its interest for a wide range of market participations. The three major characteristics are: the creation of an asset portfolio (debts or securities, in cash or as derivative products); the disconnection between the credit risk of the portfolio and that of the originator through the use of an ad hoc vehicle (special purpose vehicle); and the slicing of the securities portfolios. According to the writer, the transfer of risk enabled by asset securitization had two consequences. First of all, it created the possibility for certain investors, such as hedge funds, to expose themselves to new risks, for example, risk inherent to mortgage loan, which were previously exclusively reserved for banks. Second, the new capacity of the financial intermediaries to give up all or a part of their risks enabled them to have better active-passive management, to improve exposure to risk and diversify their loan portfolio. The commentator

50 Non-adjusting creditors include involuntary creditors, such as tort creditors, as well as voluntary creditor that, for whatever reason cannot adjust their interest rates.

51 C Peicuti, 'Securitization and Subprime mortgage crisis' JPKE (2013) Vol. 35(3) 443-456.

also submits that the development of asset securitization caused a decline in interest rates in mortgage loans because:

> Asset securitization enables banks to diversify their risk profile and free statutory equity capital in order to increase their lending capacity. In this way, the financial institutions were able to increase their credit offer while reducing its cost. This volume effect is coupled with a price effect: asset securitization strengthens the competition among financial institutions or among buyers of securitized products.[52]

Countering the contention that asset securitization undermines bankruptcy policy, Schwarcz submits that the contention is a "chimera". According to the commentator, the originator after all, freely makes the choice of its financing transactions and that asset securitization has a lower cost precisely because of bankruptcy remoteness. Thus, if the originator chooses asset securitization for it to benefit from that lower cost, it should not have the right to later complain. In addition, the very availability of asset securitization as a finance option in providing liquidity to otherwise viable originator unable to borrow has been demonstrated to facilitate the fundamental bankruptcy policy of debtor rehabilitation.

Be that as it may, Peicuti also acknowledges that since the outbreak of the subprime mortgage crisis, the benefits of asset securitization have started to be questioned. This is because, even though, originally, asset securitization was meant to improve the efficiency of capital markets by reducing risk through risk tiering and geographic diversification and contributed to a reduction in transaction cost and greater flexibility in financial operations, as it turned out, it seemed to play a major role in fuelling the dynamics of the subprime mortgage. According to the commentator, one of the explanations that have been put forward is that the lender no longer has an interest in minimizing losses because asset securitization breaks the link

[52] ibid, 446.

between the loan originator and the loan risk. Moreover, asset securitization permits the creation of the asset-backed credit default swap, (ABS CDS), and the collateralized debt obligations (CDO). By this, it has provided and greater amount of capital to the subprime market than would have been available in the absence of the fund flowing from investors via CDOs. This extended the already existing subprime bull market.[53]

Peicuti however queries, "is securitization the cause of the crises? And if this is the case, should it be made illegal? If we no longer trust the securitization process and its results, how can we trust financial markets?"[54] He submits that it is too late in the day to do away with asset securitization. According to him, with the American and European societies living on credit that is globally financed by the emerging economies, it is no longer possible to go back to local traditional originate-to-hold banking system and an immediate corrective structural measure would have amplified the problems generated by the crisis rather than settling them. He, however, recommends that over the next ten years, a rethinking and reforming of the originate-to-distribute banking model is necessary for the stability of the financial system. The challenges for the regulator include protecting the capacity of innovation of the system and reducing the systemic risk due to the problem of uncontrolled spread of new risks. It was further submitted that even if asset securitization in and of itself is not responsible for the subprime mortgage crisis, many more underlying credit problems will be made far worse in the years to come by the possibility of securitizing just about any poorly designed financial products. Therefore, it is recommended that regulators should determine what underlying

[53] ibid, 443.
[54] ibid, 444.

assets should qualify and under what conditions in order to avoid fuelling any dynamics similar to that of the subprime mortgage crisis.

The position taken by this study is that there are ample justifications for asset securitization as part of the right of a property owner to make various disposition of his or her property, subject however to compliance with applicable legal and regulatory rules.

1.9 Research Methodology

The study is a work of legal research.[55] It adopts the analytical research approach involving analysis of case law and statutory provisions by application of the power of reasoning. Methodologically, the work was organised around legal propositions, while primary sources of law served as the main sources of data, its secondary sources played supportive role. The work finds primary sources of law or primary authorities and searches secondary authorities for background information on the subject.[56] Three basic steps were undertaken. These are:

I. finding the relevant provisions of the law on the subject matter of this study in the primary sources of the law;

II. finding the opinion of experts and scholars on the subject espoused in journal and law review articles, and so forth; and

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[55] The Black's Law Dictionary defines "legal research" as the finding and assembling of authorities that bear on a question of law- A G Bryan (ed.), Black's Law Dictionary, (8th edn, West Group, St. Paul, Minn., 2004), p.915. Legal research has also been defined as the "field of study concerned with the effective marshalling of authorities that bear on a question of law" – P R Aiyar, (ed.) *Advanced Law Lexicon*, (3rd edn Reprint. Wadhwa and Company Nagpur, New Delhi, 2007) Vol. 3, p. 2688.

[56] The primary sources of Law in Nigeria are the Constitution, the received English law, and other Nigerian legislations, judicial decisions of superior courts, Nigerian customary law, and international law while the secondary sources include law texts, books, treatise, periodicals, journals and legal digests. See D Olowu, and F Lasebikan 'Sources of Law in Nigeria' in A O Sanni, (ed.), *Introduction to Nigerian Legal Method*, (2nd edn, Obafemi Awolowo University Press Ltd., 2006), pp.245-262. See also, M O Sofowora, *Introduction to Nigerian Legal System & Basic Principles of Contract* (Soft Associates, Lagos, 1997) 7; N Tobi, *Sources of Nigerian Law*, (MIJ Professional Publishers Ltd, Lagos, 2007) 17-152.

III. finding non-legal sources for materials that support or negate analysis or position on the matter.

1.10 Summary

In this introductory chapter, the study discusses the background to the study, statement of the problem, aims and objectives, operational definition of terms, research questions, theoretical framework and research methodology. The chapter points out that asset securitization, which is the focus of the study, is one of the new methods of financing beyond the horizon of the traditional equity and debt financing. Other methods of financing and credit restructuring include, trust, factoring, discounting, novation, loan selling, participation, sub-participation and swaps. The chapter draws a distinction between asset securitization and securitization in the literal and general sense.

The chapter notes that securitization, in the literal and general sense, will encompass debenture, bonds, notes and other debt instruments which are cognizable and regulated under the Investment and Securities Act, 2007 and applicable provisions of Companies and Allied Matters Act, 1990 but that asset securitization in the technical sense is the focus of this study. The study describes asset securitization and submits that the end product of asset securitization is the creation of asset-backed securities (ABS) which must be distinguished from securities in the usual capital market instruments. Therefore, whereas a usual capital market instrument is an exposure in the business of the issuer, an ABS is simply an exposure in an asset, or a bunch of assets.

The chapter points out the motivation for the study which include: first, the recent experience in the Nigerian banking sector where some banks had huge amount of receivables and yet became technically insolvent because they lacked immediate funds to match their regulatory capital requirements and their financial obligations; second, it is found that the National Pension Commission by its Regulation on Investment of Pension Fund Assets provides window for investment in asset securitization which is not being utilized; third, the possibility of asset securitization helping in addressing the challenges in the housing sector; fourth, possible utilization of asset securitization facilitating access to immediate funding from the capital market to address the infrastructural problem; fifth, the passage of the AMCON Act opening a vista for possible promotion of asset securitization in Nigeria; lastly, the interconnectedness of market in the now globalized world.

The chapter considers the problems that impel the study. While noting that applicability of different laws to asset securitization in Nigeria by itself does not constitute problem, the study finds that the real problem is that, while asset securitization has its peculiarities, these potentially applicable legal provisions were fashioned out as general property and corporate law provisions not specifically tailored for asset securitization. This, it is submitted, raises the problem of adequacy of the extant relevant provisions to structure asset securitization given the peculiar requirements of the transaction. There is also the problem of legal risks to asset securitization under existing law and the extent that these legal risks can be mitigated using contractual and due diligence mechanisms. Another problem has to so with legislative competence to make legislation on asset securitization. This arises because the applicable legal provisions to asset securitization straddle legislative competence of federal and state legislatures. Another problem is the inadequacy of the existing legal framework for security interests, particularly priority and enforcement of security interests, to support asset securitization.

The chapter sets out the aims and objectives of the study, research questions and operational definition of key expressions used in the study. It sets out and discusses the theoretical framework for asset securitization and expresses preference for efficiency theory of asset securitization. As a legal research, the study adopts analytical research methodology.

Chapter Two

Literature Review

2.1 Introduction

Notwithstanding the nascence of the development of asset securitization, there exists a body of literature on the subject matter. Using general categorisation, the focus of existing literature is diverse and inherent in this are: asset securitization and its features, general treatise on asset securitization; nature of asset backed securities; capital market and financial disintermediation; development of asset securitization within specific countries or regions; rating agencies; and theoretical justifications for asset securitization. Suffice to note that some aspects of the reviewed literature on theoretical justifications of asset securitization have been considered under theoretical framework in Chapter One and will not again be set out here to avoid needless repetition.

2.2 Meaning, Types of and Definition of Asset Securitization

According to Jobst, asset securitization is the process in which certain types of assets are pooled so that they can be repackaged into interest-bearing securities. The interest and principal payments from the assets are passed through to the purchasers of the securities.[57] In the view of Robbe, asset securitization is a financing technique in which the cash flow from an underlying pool of exposures is used to service at least two tranches of notes reflecting different degrees of risk.[58]

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[57] A Jobst, *What is Securitisation* (n 11) 48.
[58] J V Robbe (n 11).

Robbe identifies three types of securitization: true sale securitization; synthetic transactions and whole business securitization (WBS).[59] True sale securitization is the commonest type and it essentially involves sale (assignment) of the assets (typically loan receivables) from the originator to the Special Purpose Vehicle (SPV).[60] In this transaction type, the originator sheds all risks[61] associated with the receivables. The distinguishing feature of synthetic securitization is that only credit risk of the assets referenced is transferred to the SPV. Thus, in synthetic securitization, there is no assignment, which identifies the true sale transaction.[62] The whole business securitization is a hybrid between corporate finance and full-fledged securitization and it is typified by ring-fencing of part of the company's activities able to generate a predictable receivables cash flow, and securing same for the benefit of the note holders.[63]

Alli describes WBS as essentially back-to-back loans in that an "SPV issue securities to investors and lend the proceeds from the issue of the securities to a corporate borrower; the payments made by the borrower on the loan are used to service the securities."[64] He, however, identifies another type of securitization called inventory securitization, which, according to him makes it possible for borrowers to use their inventory to raise funds while overcoming the legal and practical difficulties encountered in conventional lending by attempting to create

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59 ibid 5.
60 ibid 6.
61 Not just credit risk.
62 J V Robbe (n 11) 6.
63 ibid 6.
64 P U Alli (n 21) 7. The relative merit and the peculiar utility of whole business securitisation has been put thus: "This fundraising mechanism has been able to deliver greater leverage and longer terms to maturity than conventional secured lending, due to the greater tolerance for higher gearing ratios on the part of investors in the capital markets compared to banks. However, on the other hand, as the loan to the borrower has effectively made by the investors, this funding mechanism has, in practice, largely been limited to borrowers with stable cash flows and which enjoy a strong market position and operate in markets with high barriers to entry"

a fixed charge over the inventory. In inventory securitization, the SPV lends the proceeds of debt securities issued by it to the borrower and the loan is secured by a pledge of the borrower's inventory and the borrower's payments of the loan, which are funded by the sale of the inventory, are used to service the securities.[65] Alternatively, the proceeds from the issue of securities are used by the SPV to acquire inventory from the borrower and the securities are serviced by the sale of the inventory.[66]

The mechanics of asset securitization as explained by Kothari is that it is essentially premised on the idea of asset-based funding. As a concept, asset-based funding means that an investor is taking primarily an exposure on an asset. The central inspiration of asset securitization seems to be that it seeks to transfer assets to investors but since assets are a source of income, transfer of such asset cannot imply transfer of all of such income to the investor. This is because the originator would be left high and dry. Therefore, a befitting midway solution is that the originator originates or creates the assets that generate income over time and the asset is transferred to an investor. However, the originator continues to manage/administer and service the asset in question and he extracts his profit, that is, the income generated by the asset less the desired return of the investor, in one or more ways. It is because of this that an SPV is involved in asset securitization. The SPV is described as a transformation device whose main purpose in asset securitization is to convert an asset into a capital market security. Therefore, the key features of asset securitization that distinguishes it from traditional

[65] This is said to be similar to the whole business securitization structure- P U Alli, (n 21) 8.
[66] This is said to be similar to a conventional securitization except that the assets being securitized are goods rather than receivables- P U Alli (n 21) 8.

methods of funding are: Asset based funding; the nature of assets; transfer of assets by the originator; marketable securities and use of special purpose vehicles.

Asset funding is a crucial distinguishing characteristic of asset securitization because the investor primarily looks at the assets, as if he is paying money to buy certain assets, and not at an obligation on the part of the originator to pay. It is required that these assets be specific and ascertained assets of the originator as otherwise investing in the general assets of the originator is no different from buying a security of the originator. Also, the assets to be securitized are mostly financial assets, that is, claim to a certain stream of cash flows. This is because investors pay upfront to buy such assets and thus would require certainty as to their payback.[67]

Transfer of assets is crucial to asset securitization. The transfer is structured to isolate the assets from credit for credit exposure for the asset securitization sponsor and, potentially to remove the assets from the sponsor's balance sheet and that proceeds of the transfer may be used to originate new assets to repay outstanding debts, or for any other allowable purpose. Furthermore, the valuation of the portfolio of assets, and hence the credit quality and anticipated timing of repayment of the debt issued in asset securitization, is based largely on projected cash flows on the assets sold as impacted by assumptions regarding prepayments and loses due to delinquencies and defaults.

[67] V Kothari, 'What is Securitisation?' available at http://india-accounting.com/arc/whatz_securitisation.PDF last visited on February, 10, 2014.

There has also been attempts to offer suitable definition for securitization following the global financial crisis in which securitization has been blamed. According to Giron and Chapoy,[68] the great transformation of the financing process by financial intermediaries beginning with financial deregulation and liberalization makes securitization and financialization[69] the biggest cause of the recent financial crisis. According to them,

> The financialization process consisted of the buying and selling of assets or financial securities that can take place in orderly form in the capital markets. The new jointing of large conglomerates participated in this through off-balance-sheet transactions with derivatives or financial products and services that were the consequence of technological and financial innovations. The financial intermediaries' need for liquidity made it possible for the securitization of assets to take on a life of its own in financial transactions, this being a process that is endogenous to the development of financialization.[70]

There has been an interesting debate between Lipson[71] and Schwarcz[72] as to definition of securitization, particularly after the global financial crisis. Lispon defines securitization as:

> a purchase of primary payment rights by a special purpose entity that (1) legally isolates such payment rights from a bankruptcy (or similar insolvency) estate of the originator, and (2) results, directly or indirectly, in the issuance of securities whose value is determined by the payment rights so purchased.

While Schwarcz commends Lipson's article as by far the most systematic and thoughtful analysis of what securitization should mean, he states that he has several concerns with Lipson's definition of securitization. According to Schwarcz, the definition of Lipson is overly restrictive in so far as it limits inputs to "primary" payment rights. According to the commentator, the implicit rationale of Lipson's limitation is that primary payment rights are

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[68] A Giron, and A Chapoy, 'Securitization and Financialization' JPKE 2012-2013, Vol. 35. No. 2, 171.

[69] Giron and Chapoy define finacialization "as the process whereby the profitability of financial capital, through financial innovation, surpases the transactions of the international monetary system". ibid at 173.

[70] ibid. 172.

[71] J C Lipson, 'Re: Defining Securitisation' http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1996017&rec=1&srcabs=1996670&alg=1&pos=2 last visited of 24 September, 2013 and J C Lipson, 'Why (And How To) Define Securitization? A Sur-Reply to Professor Schwarcz' 85 S. Cal. L. Rev. 1301 2011-2012 downloaded from http://heinonline.org on Friday May 17, 2013.

[72] S L Schwarcz 'What is Securitization? And For What Purpose?' 85 S. Cal. L. Rev. 1283 2011-2012 downloaded from http://heinonline.org on Friday May 17, 2013.

inherently stronger than non-primary payment rights. However, Lipson does not explain why relative weakness should be a normative basis for definitional distinctions, nor does Lipson explain why primary payment rights are inherently stronger than non-primary payment rights. Schwarcz believes that they are not always stronger.

To Schwarcz, for example, non-primary payment rights can include rights, such as guarantees from creditworthy third parties and two-party paper like bankers acceptances that are much stronger than the underlying primary payment rights. Some primary payment rights, such as mortgage payments due on subprime mortgages, are very weak indeed. Schwarcz also questions Lipson‘s examples of Collateralized Debt Obligations (CDOs) and Enron‘s structured financings as being distinct from securitization because they did not rely on primary payment rights and thus had weaknesses. For example, he requires legal isolation of the repayment source from a bankruptcy (or similar insolvency) estate of the originator, when the originator is of investment-grade quality, however, many securitization transactions do not necessarily achieve such legal isolation. According to him, excluding from a definition transactions commonly regarded by market participants as part of that definition raises a normative question: Should the definition of a type of observed event exclude events that third-party observers generally would expect to be of that type?

Finally, he submits that Lipson‘s characterization of the outputs is potentially inaccurate insofar as it requires the “value” of the securities to be “determined” by the source of payment. The source of payment, however, merely determines the likelihood that the securities will be repaid on a timely basis, whereas the “value” of securities depends not merely on their likelihood of timely repayment but also on their interest rate (or rate of return). Therefore, because the rate of return is market driven and extraneous to securitization *per se*, a more accurate characterization of the outputs would state that collections on the payment rights purchased are the primary source of repayment of the securities.

Schwarcz, in advancing his own definition believes that even a normative approach to defining a financial concept, such as securitization, should be pragmatic, taking into account how the concept is used in the real world. He thus defines securitization as:

> "A financial transaction in which (1) a special purpose entity issues securities to investors and, directly or indirectly, uses the proceeds to purchase rights to, or expectations of, payment, and (2) collections on the rights or expectations so purchased constitute the primary source of repayment of those securities."[73]

The commentator further advances what he called "audience-adaptive approach" to defining securitization by which the basic pragmatic definition will be slightly modified depending on the audience. For instance, to the extent the audience members consist of lawmakers, transactional lawyers, and market participants, the scholar said he would add "that the special purpose entity does not speculate in the rights to, or expectations of, payment that it purchases". For media purposes, securitization would be defined for the media and the public to make it more accessible as "a transaction in which a special purpose entity, such as a trust, (1) issues certificates, promissory notes, or other securities to investors; (2) uses the cash received from the investors to purchase mortgage loans or other similar assets on which payments are expected to be made; and (3) ultimately uses those payments, if and when received, to repay the investors."

[73] S L Schwarcz, *What is Securitization? And For What Purpose?* (n 72).

In a sur-reply to Schwarcz, Lipson scrutinized the several criticisms Schwarcz made.[74] According to Lipson,

> at bottom, Schwarcz and I differ over institutional choices and functions in defining terms in commercial finance law. By "institution" I mean the several (more or less) discrete, large-scale social constructs through which we order our affairs, such as markets, political bodies, courts, and so on.[75]

Different institutions exhibiting different dynamics can solve the same problems in somewhat different ways and thereby present options about how those problems can be solved, Lipson writes.

Lipson submits, as regards the disagreement by Schwarcz with the former's definition because it is "overly restrictive', that aside the irony of the position of Schwarcz, the latter has, himself, offered several definitions of the term. He further submits that the chief problem with Schwarcz's approach is that markets seem to make significant mistakes in this arena because they tend towards a level of financial and definitional complexity that makes clarity difficult, yet, a clear definition is imperative. Lipson, therefore, contends that Schwarcz's definition offers a good example of definitional complexity. Lipson also found it as a surprise that Schwarcz criticizes the institutional choice made by him in defining securitization because, according to Lipson, one of the many accomplishments of Schwarcz was to give early warning that complexity in financial products had the potential to create larger systemic problems.

Lipson responds that the concern by Schwarcz that the former emphasizes the role that primary payment right should play in securitization and that he does not explain why relative

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74 J C Lipson, *Why (And How To) Define Securitization? A Sur-Reply to Professor Schwarcz* (n71).
75 ibid.

weakness should be a normative basis for definitional distinctions is not the case. According to Lipson, primary payment rights are important to a normatively preferable definition of securitization for two reasons.

First, the data speaks for itself. With the exception of real estate mortgage-backed securities ("RMBS"), transactions using primary payment rights-credit card receivables, equipment loan receivables, and so on generally performed much better than "synthetic" securitizations, which involved merely the recycling, or "repackaging," of existing primary payment rights. Primary-payment inputs resulted in more successful transactions than those that relied on less direct inputs. Second, the real question is not whether particular assets are strong or weak as a financial matter. Instead, the question is about meaning. Lipson admitted that Schwarcz is correct that primary payment rights can also be quite weak but the strength that Schwarcz has in mind is financial but the strength that concerns him is definitional. Accordingly, a simpler and more restrictive definition is stronger because it excludes more complex transactions, such as CDOs. He also finds it curious that Schwarcz also questions his examples of CDOs and Enron's transactions as not being securitization because Schwarcz had argued that Enron's transactions were not securitization.

Lipson also points out that even though both Schwarcz and he shared the goal of developing a definition of securitization that is clearer than current definitions, he questioned whether Schwarcz' definition will achieve the laudable goal of clarity. His reasons are: First, is the preference of Schwarcz for market-based definitions of securitization whereas the market's incentives to define securitization clearly are uncertain, at best. Second, and more practically, the breath of Schwarcz' definition with respect to inputs contributes to the conditions that led to the trouble in the financial sector in the first place.

2.3 Asset Securitization and Asset-Backed Securities

In the widest conception, every process that converts a financial relation into a transaction, particularly a capital market instrument, is "securitization". Applying this wide conception, the ordinary share, which practically translates to piecemeal ownership of the company, may be said to be the earliest instance of securitization.[76] Another instance of securitization in the generic sense is tradable loans in the form of debentures.[77]

In modern times, securitization has acquired narrower and technical meaning and it involves the raising of finance, (debt), through the issuance of securities in the capital and money markets. The borrower will raise funds directly from market investors as opposed to seeking finance in the form of a bank loan or overdraft from the banking system.[78] The contemporary conception is that asset securitization is a process that transforms an asset into a security and the resulting security is called an "asset-backed security".[79] What then is the nature and characteristics of this asset-backed security?

In contradistinction to a capital market instrument which is an exposure in the business of the issuer, an asset-backed security is simply an exposure in an asset, or a bunch of assets.[80] Also,

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76 V Khotari (n 6) 5. According to the commentator, the ordinary share was so instrumental in the growth of the corporate form of doing business and hence industrialisation that someone rated it as one of the greatest inventions of the 19th Century, the other being the steam engine.

77 ibid. Kothari makes reference to a statement by Henry Dunning McLeod that: "The man who first discovered that a debt is a saleable commodity ... made the discovery which has mostly affected the fortunes of human race".

78 G G Giglio 'Asset Securitisation in Argentina' (2005) 20 (10) JIBLR. 514.

79 V Khotari (n 6) 6.

80 ibid, 7.

an asset-backed security is not a claim on an entity but a claim on a pool of assets.[81] Two points have been highlighted in this context: one is that the distinction between claims on assets and claims on entities is to an extent ephemeral because in the final analysis, the two seem to merge. Second is that any claim on any entity is also ultimately a claim on the assets of the entity and that the very concept of limited liability companies makes all financial claims as claims on assets.[82]

Therefore, Fabozzi and Kothari, while arguing that all securities are ultimately asset-backed, submit that there is a significant difference between assets of the entire enterprise and those that are isolated as a specific pool and that once the isolation of the pool happens, investors in the transaction will only be impacted by the risks of those specific assets and not the general business risks of the mortgage lender. Further, there is no value added merely by securitizing assets but the only source of value added is by a sort of inter-creditor arrangement whereby an asset-backed investor is provided two advantages - legal and structural preferences.[83]

Legal preference refers to the preference that an asset-backed investor enjoys over a traditional investor as a claimant on the assets of the operator. The claim of the traditional investor may be subject to the vagaries of bankruptcy proceedings and statutory preferential claims. However, in asset securitization, the investor has a claim over the assets of the operator because those assets have been hived off and made legal property of the investors and thus sub-serves the claims of the investors before they can be claimed by anyone else. The creation of this legal preference, according to Fabozi and Kothari, is the key to asset

81 F J Fabozzi and V Kothari (n 11).
82 ibid.
83 ibid.

securitization.[84] The mechanisms for achieving legal preference are by transfer of assets and the use of the SPV.

On the other hand, structural preference refers to the stacking order of mutual rights among the different classes of investors which is effected by creating different classes of mutual rights and issuance of different tranches of securities. Although the structuring of mutual rights is not unique to asset securitization, it is submitted that the structuring becomes more meaningful in the case of asset securitization in view of the isolation of entity risks.

2.4 Benefits of Securitization

There also exists a body of literature on the general benefits of securitization. Apart from being a source of funding, Fabozzi and Kothari opine that securitization has the potential for reducing funding cost. Cost of funding depends on the credit rating assigned to a debt obligation issued by an entity and rating.[85] Securitization achieves the benefits of cheaper funding "when the originator's credit rating is relatively low, and the notes backed by the originator's assets can be sold to capital market investors significantly cheaper as their creditworthiness is de-linked from that of the originator."[86] In securitization, the rating agency will assign a rating to each security based on the expected performance of the asset pool and the priority of a security in the structure, hence, the rating assigned to each security issued by the SPV will be independent of the financial condition of the originator company. Therefore,

[84] ibid.
[85] F J Fabozzi and V Kothari (n 11).
[86] J V Robbe (n 11) 3.

the originator company can have "a speculative-grade rating, but the SPV can issue one or more securities with a much higher credit rating".[87]

Hwa[88] submits that asset securitization has other benefits aside from being a tool for financing which include: achieving asset sale; opening up additional sources of finance; improving a company's debt-to-equity ratio; decreasing the costs of finance; and achieving capital efficiency. He examines the development of asset securitization in Singapore and finds that the slow progress of asset-backed securitization in Singapore can be attributed to certain factors. There is excess domestic currency liquidity in Singapore and this made borrowing cheaper in the domestic market. However, in order to raise offshore financing through asset-backed securitization (ABS), the issuer has to bear the additional costs of cross-currency swaps. Moreover, for a sizeable international ABS transaction, the US Dollar/Singapore Dollar cross-currency swap market is not liquid enough. For major financial institutions, straight funding is cheaper than securitised debt and there is also limited capital/regulatory pressure on the banks to benefit from securitization. He further submits that there is a need to tap the vast pool of international institutional investors beyond the domestic investors for the growth of ABS market and that for this to happen, the ABS would have to be rated by the major rating agencies. The swap market has to expand to accommodate the swapping of U.S dollar proceeds to Singapore dollar. On the whole, the commentator finds that recent securitization transactions augur well for the further development of asset securitization in Singapore.

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[87] F J Fabozzi and V Kothari, (n 11).

[88] N K Hwa, 'Asset Securitisation in Singapore' (2000) 15(11) JIBL.

Hahn[89] submits that asset securitization has some disadvantages for originators, including significant initial transaction[90] and on-going compliance costs and reduced control by the originator of the assets sold to the Special Purpose Vehicle.[91] He also acknowledges that asset securitization offers several advantages to originators, including balance sheet management, lower cost of funds and access to additional funding sources. Further, he finds that in some cases, due to either the low quality of the assets involved or the lack of operating history of the Originator,[92] or both, the costs of credit enhancement, when combined with the high transaction costs of asset securitization generally, may actually make asset securitization more costly for an originator than a bank financing.

Writing on financing of Micro, Small and Medium Enterprises (MSMEs) in Nigeria, Amokaye submits that asset securitization offers a great variety of benefits to both MSMEs and investors.[93] According, to the commentator, the benefits to the MSMEs include: improved asset-liability management and access to longer term funding; enabling issuers with sufficiently high level of balance sheet assets to transfer future cash flows generated from their operations to an SPV which then refinances the acquisition of assets by means of issuing debt securities to capital market investors; and giving the company the opportunity to have better knowledge of the assets that may facilitate effective credit management. From the

89 R J Hahn, 'Securitization: An Introduction' available at http://www.hunton.com/files/tbl_s47Details/FileUpload265/1274/Securitization_An-Introduction_Hahn.pdf last visited on 15th March, 2010.

90 According to the scholar, costs with respect to a securitization transaction are generated by a variety of professionals required to complete and maintain such transactions, including attorneys for the Originator and the other parties, trustees (in many cases), rating agencies, accountants and investment banks, placement agents or financial advisers.

91 The disadvantage of reduced control of the assets by the originator is somewhat mitigated through the Originator's retention of servicing rights.

92 In this regard, it was noted that a rating agency often looks for three years of operating history of an Originator before it will agree to rate a securitization involving the Originator's assets.

93 O G Amokaye, 'Financing of Micro, Small and Medium Enterprises (MSMEs) in Nigeria: Security Options' (2006) Vol.1 CLS 86.

investor's perspective, Amokaye submits that asset securitization widens the investor's base for SME credit risk by providing him the opportunity to diversify some of the investor's portfolio from large corporate exposure to quasi-retail risk and allowing easy marketability of securitized loans because they are standardised and liquid.[94]

Jing He has alluded to theory of financial innovations' constraints in justifying securitization.[95] According to this theory, financial product innovation is an organization's (banks or enterprises) response to suffered constraints. Main constraints include laws, risks, and competitions. Securitization of international syndicated loans is, therefore, a kind of assets management innovation emerged in the reforming tide of financial industry. It comes into being in conflicts between financial activities and financial environment.

Three reasons were advanced by Jing He in the context of the theory of constraints for the emergence of securitization of international syndicated loan that is, to shun external pressure from banking supervision, inner requirement for decentralizing operational risks and improving rate of profits and competitiveness. He describes the latter reason as 'the ultimate engine for securitization of international syndicated loans.' According to him:

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[94] ibid, 119.

[95] J He, 'On Securitization of International Syndicated Loans' IJBM (2008) Vol. 3 No. 11, 151 Nov 2008. Available at: www.ccsenet.org/journal.index.phb/ijbm/article/viewfile/999/958; last visited on 8 December, 2015

> Profits-assets ratio is the standard that evaluates the profitability of a bank. If the leading bank sells syndicated loans by securitization, it can deduct the loan assets from its balance sheet. Meanwhile, the leading bank retains rights of getting parts of interests and charging for commissions. Under some circumstances, it even gains some interests margins. All these factors benefit the improvement of bank's profitability. Besides, just as what has discussed above, securitization enhances the liquidity of syndicated loans. Participated banks can take back some capitals before loans are terminated, and use them for other businesses. By expediting the circulation of credit capitals, operational scale of bank assets is larger and the rate of return on assets is improved, that will inevitably benefit the rise of bank's rate of profits. Moreover, as the realization of sales income, securitization of syndicated loans is free from handing in reserves. It effectively reduces costs of financing.[96]

The commentator is of the view that securitization has become "the most energetic financial innovative product that develops fast in all countries' capital markets today" because it has innovative financing structure, effective carriers and satisfies the constantly changing needs of different borrowers and investors.

An, Deng and Gabriel submit, from evidence from CMBS Market, that despite recent constraints on secondary market funding and liquidity, there is substantial value-creation associated with the securitization of commercial mortgages. The value creation would derive, among other things, from enhancements to originator liquidity, gains from specialization in origination, servicing and holding, tranching of pool cash flows so as to target distinct investors' classes, regulatory arbitrage and the like.[97]

2.5 Asset Securitization, Capital Market and Financial Disintermediation

Asset securitization is an aspect of derivative market. There is the view that in light of current rapid economic integration, an attempt to foist derivative products on the Nigerian capital

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[96] ibid at 155.
[97] X An, Y Deng and S A Gabriel, 'Value Creation Through Securitization: Evidence from the CMBS Market' (February 2008). Available at SSRN: http://ssrn.com/abstract=1095645 or http://dx.doi.org/10.2139/ssrn.1095645 last visited on 21 April, 2014.

market is imminent because of its acceptability to the financial systems. On the contrary, there is another view that the derivative market is the most vulnerable amongst other securities because it is based on speculative tendencies and transfer of risks in transactions, which are mostly treated as off-balance sheet instruments.[98]

The idea behind asset securitization is to move funding from the banking world to the investment world.[99] This, in turn, has led to a debate on the possible continuous relevance of traditional banking.[100] The framework within which the analysis of asset securitization has generally taken place has been said to depict an evolutionary process of increasing financial market efficiency.[101] This framework is utilised by Rybczynski,[102] who argues that the evolution of the financial system, which occurs as the economy expands, involves three stages. The character of the financial system in the first stage is primarily a bank-orientated one; banks are the main channel for collecting and investing savings. The financial system develops towards a market-orientated stage where capital markets channel a large proportion of savings directly, (primary securitization), and later to a strongly market-orientated stage where financial institutions increasingly dispose of and trade in their assets, (secondary securitization). Each new stage of the process feeds on and develops from the other.

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98 L I Juwah, 'Securities Regulation: Issues of Ethics and Compliance in the Capital Market of Nigeria' (2005) 20(4) JIBLR 193 at 197.

99 This can be seen with the growing preponderance of capital market signalling the institutionalisation of finance. V Khotari (n 6) 9.

100 G G Giglio (n 78) 514 contends that securitization will gradually lead to the erosion of the traditional role of banks as the providers of loan capital.

101 ibid.

102 See T M Rybczynski, 'Financial Systems, Risks and Public Policy' [1985] Royal Bank of Scotland Review 35-45.

Giglio submits that with this evolutionary model, there have emerged at least two schools of thought on the implication of the structure and the future role of banks within the system.[103] According to him, the proponents of the "market school" contend that asset securitization implies a continuing and inevitable decline in the role of international banks and that asset securitization heralds the end of traditional banking, which they view as being based primarily on financial intermediation. According to him, more extreme proponents within this school go further and postulate that asset securitization marks the potential demise of many kinds of banks altogether. The argument is that one of the basic rationales for the existence of banks is their ability to exploit market imperfections.

Giglio notes that the market school points to an increased efficiency, a growing sophistication of capital market participants, and the rise of corporate in-house banks. He sums up that for the market school, asset securitization is an indication that the market is omniscient and that the role of banks in general financing activities and resource allocation within society will steadily diminish.[104]

An opposite view was stated by Giglio to be espoused by the "banker school" which contends that asset securitization is merely one more step, albeit a quantum leap, in the development of the modern banking firm; a step which may even be reversed at some point in the future. This second school of thought, according to him, is ultimately confident of the adaptive and innovative powers of banks to survive and prosper. He further notes that the banker school

[103] G G Giglio (n 78) 514-515.
[104] ibid.

points to the modern record of banking innovations and believes in the ability of banks to develop new lines of business.[105]

Notwithstanding the disputation between the market school and the banker school, it appears that the real effect of asset securitization on the traditional banking is better explained from the point of view of its role in financial disintermediation.

Fabozzi and Kothari[106] explain that it was because of the disadvantages associated with individual investors lending to corporations, as well as lending to other individuals, that there is a need for financial intermediaries.[107] A financial intermediary like banks raises funds from individual investors and then lends those funds to corporations and individuals. Financial intermediaries provide one or more of the following three economic functions: they provide maturity intermediation, reduce risk via diversification, and mitigate the costs of contracting and information processing. Fabozzi and Kothari demonstrate how asset securitization performs these roles. As regards maturity intermediation, a pool of assets can be used to create asset-backed securities with different maturity ranges; diversification within an asset type is accomplished because of the larger number of loans in a typical asset securitization;

[105] ibid, 515.
[106] F J Fabozzi and V Kothari (n 11).
[107] According to Fabozzi and Kothari: "At least three problems arise in a world without public debt markets and financial intermediaries: transactional difficulty, informational difficulty and perceived risk. Transactional difficulty arises because an individual investor may not have sufficient funds to satisfy the amount needed by the borrower, nor might the tenure of the loan sought by the borrower match what the individual investor is willing to grant. There is informational difficulty because the individual investor may not be capable of assessing the creditworthiness of the borrower. Finally the individual investor's perception of the risk associated with a loan will be based on only the credit risk of the borrower with no opportunity to diversify that risk over other borrowers"- (n 11).

finally, the costs of contracting and information processing are provided in asset securitization.[108]

There is, however, one activity that is performed by some financial intermediaries that is not replaced by asset securitization and that is the distribution to the public of the asset-backed securities created from asset securitization transaction as well as maintenance of the secondary market. Technically, the distribution of securities and the maintaining of secondary markets are not roles of financial intermediaries but that of investment bankers. Fabozzi and Kothari, therefore, conclude that as more corporations shift from borrowing from financial intermediaries, the role of underwriting by investment banks will increase while their role as lenders will decline. Further, with asset securitization, the types of fees generated by financial intermediaries will change. Fee income from loans and the corresponding costs charged in granting those loans, which are embedded in the loan rate, will be replaced by fees for distribution and market making.

Another explanation of asset securitization from disintermediation perspective is that of Klee and Butler whose submission is that disintermediation is the elimination of intermediaries in the supply chain[109] and that, in the financial markets, disintermediation is characterized by a weakening in the relationship between banks and their customers and a concomitant increase in direct relationships between the ultimate suppliers and users of financing. Accordingly,

[108] According to the commentators: "The contracting costs are provided by the originator of the loans. Information processing is provided at two levels. The first is when a loan is originated. The second is when a rating agency rates the individual asset-backed securities in the transaction" - F J Fabozzi and V Kothari (n 11).

[109] This is commonly referred to as cutting out the middlemen.

rather than taking a permanent position as secured or unsecured lenders, financial institutions are increasingly acting as facilitators or conduits of financing transactions.

The role and benefits of asset securitization by way of disintermediation is ably captured by Klee and Butler as follows:

> Asset securitization is a species of disintermediation inasmuch as it permits a company to acquire reduced-cost financing through the removal of intermediaries, such as bank lenders, that previously stood between a company and the ultimate source of money, the financial markets. Through asset securitization, a company avoids the increased transaction costs charged by middlemen financial institutions. It also enables a company to raise funds cheaply based on allocation of risks that are assessed by parties having the most expertise, such as rating agencies. [110]

Therefore, on the question of the impact of asset securitization on traditional banking, the position taken in this study is that the explanation of the effect of asset securitization from the point of view of its role in financial disintermediation is to be preferred.

2.6 Securitization of International Syndicated Loans

Jing He focuses on securitization of international syndicated loans which he describes as 'just one corner of asset securitization'[111]. According to the commentator, there are two modes of securitization of international syndicated loans. One is by way of transferable loan facilities which he describes as the primary mode. The other is the SPV mode which he describes as the advanced mode. In the practice of syndicated loans, there are three kinds of transferable loan facilities: transferable loan certificates, (TLCs), transferable participation certificates (TPCs), and transferable loan instruments (TLIs). He points out that transferable loan instrument is a

[110] K N Klee and B C Butler (n 23) 2.
[111] J He (n 95).

new loan securitization way that appears in practice on international syndicated loans in order to overcome the two identified shortcomings of transferable loan instruments.

Jing He[112] identifies shortcomings of transferable loan certificates as: firstly, if the country where the borrower lives implements foreign exchange control, even though the borrower has permission of getting foreign loans, this permission may become invalid due to contract novation, because after that the borrower will trade with other participators but not former authorized one; secondly, if the borrower provides relevant guarantee for syndicated loans, the contract novation may make related warrantors escape from guarantee liability. That is because the new contract between the borrower and the transferee replaces the old one and the former guarantee contract is subject to the old one. According to the law of contract, an invalid principal contract causes invalidation of accessory contract unless the borrower provides independent guarantee, such as demand guarantee or standby letter of credit.

The commentator, therefore, submits that securitization is the advance mode of syndication of international loan obligations. In the securitization mode, the syndicated loans' primary providers, banks, organize and collect their certain assets that are lacking in liquidity but have expectable and stable cash flow, and form a "loan pool". Then, these banks can acquire interests by selling the loan pool to a "special purpose vehicle" (SPV). The SPV issues securities by taking the loan pool's expectable cash return flow as warranty. Meanwhile, by means of ranking and promoting credits, SPV enhances the credits of securities in order to attract more investors. The loan pool's cash return flow is firstly used for paying the

[112] ibid.

principals and interests of securities held by investors. Because SPV is the core of the whole securitization trade and also the character of new syndicated loans, therefore, this kind of securitization is named as “SPV mode”.

2.7 Securitization and Special Purpose Vehicles (SPV)

Gorton and Soules offer analysis of securitization and, more particularly, special purpose vehicles. They submit that the SPVs exist in large part to reduce bankruptcy costs and find evidence consistent with this view using unique data on credit card securitization. They also submit that the existence of SPVs depends on implicit contractual arrangements that avoid accounting and regulatory impediments to reducing bankruptcy costs.[113] According to them, an SPV, or a special purpose entity, (SPE), is a legal entity created by a firm (known as the sponsor or originator) by transferring assets to the SPV, to carry out some specific purpose or circumscribed activity, or a series of such transactions. SPVs have no purpose other than the transaction(s) for which they are created, and they can make no substantive decisions; the rules governing them are set down in advance and carefully circumscribe their activities. The legal form for an SPV may be a limited partnership, a limited liability company, a trust, or a corporation. Typically, off-balance sheet SPVs have the following characteristics: they are thinly capitalized; they have no independent management employees; their administrative functions are performed by a trustee who follows prescribed rules with regard to the receipt and distribution of cash; there are no decisions; assets held by the SPV are serviced through a servicing arrangement; they are structured so that, as a practical matter, they cannot become

[113] G B Gorton and N S Soules, ‘Special Purpose Vehicles and Securitization’ available at http://www.nber.org/chapters/c9619.pdf last visited on 14 May, 2013.

bankrupt. They, therefore, submit that: “SPVs are essentially robot firms that have no employees, make no substantive economic decisions, have no physical location, and cannot go bankrupt.”[114]

2.8 Securitization and Ordinary Lending

Schwarcz opines that whereas securitization transactions are inherently complex in that they have many different steps and many parties who participate at different stages but that from the standpoint of the originator-risk assessment, they can be less complex than ordinary lending. This is because in a properly structured securitization, the sale of the financial assets to the SPV separates payment risks from the risks generally associated with the originator, including the risk of originator’s default in what is called “bankruptcy remoteness”. This bankruptcy remoteness can reduce asymmetric information by enabling the investors to focus on risks specifically associated with well-defined and well-diversified financial assets.[115] The commentator notes, however, that securitizations of ABS and MBS already issued in prior securitizations, that is, securitization of securitizations, can inadvertently cause information failure, or at least make it difficult for investors and other parties to understand risks associated with the transferred financial assets and in these more complex transactions, relatively small errors in cash-flow projections can have dramatic consequences.[116]

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[114] ibid.

[115] S L Schwartz, ‘The Roberta Mitchell Lecture: Structuring Responsibility in Securitization Transaction’ 201240 Cap. U. L.. Rev. 803. Downloaded from http://heinonline.org; last visited on Friday May 17, 2013.

[116] ibid.

2.9 Originate-to-distribute Securitization and Lending Standards

Eggert contends that the originate-to-distribute model of securitization by which lenders are able to sell off their loans as they are made caused mortgage lenders to relax their lending standards, leading to the multitude of risky subprime loans that now constitute a huge portion of the foreclosures in the United Sates.[117]

Schwarcz however contends that originate-to-distribute model of securitization was not the primary culprit. Rather, there was significant pressure on mortgage lenders to make and securitize subprime mortgage loans to expand homeownership. Also, the fall in lending standards may also reflect distortions caused by the liquidity glut of that time or it may reflect conflicts of interest between lending firms and their employees in charge of setting lending standards. Schwarcz submits that irrespective of what caused the fall in lending standards, it cannot be controverted that securitization increased the number of mortgage loans and the number of subprime loans that could be and were made.[118]

2.10 Merits of Securitization over Privatisation

Sholarin[119] examines the relative merits of securitization over privatisation and submits that while privatization has the potential to yield some economic benefits, it is not the best option for the countries in the emerging markets. Again, in so many cases, it does not suit their economic, social and political conditions because most of these Emerging Economies lack

[117] K Eggert, 'The Great Collapse: How Securitization Caused the Subprime Meltdown', (2009) 41 Conn. L. Rev. 1257-1311.

[118] S L Schwartz, *The Roberta Mitchell Lecture: Structuring Responsibility in Securitization Transaction* (n 115).

[119] O Sholarin, 'Growth Financing in Emerging Markets: How does Privatisation Compare with Securitisation?' Journal of Money, Investment and Banking Issue 2 (2008) available at http://www.eurojournals.com/jmib%202%20ola.pdf last visited on 12 March, 2010.

adequate infrastructure with which to determine the market values of financial assets earmarked for privatisation. Consequently, privatisation has left many of these countries more vulnerable and poorer than they actually were before the privatization exercise.

Sholarin, therefore, proposes asset securitization as “a more sophisticated, modern, highly effective and prudent alternative” to privatisation for raising the capital so desperately required by the emerging countries. Securitization has the potential to trigger radical transformation of economic landscape of emerging economies in that it is capable of attracting extremely large amount of capital than privatization under far more favourable terms and conditions. Furthermore, unlike privatization, securitization allows for leveraging, and it relies on different credit rating mechanism. The effect of this is to allow originator countries to tap into the global financial markets via a Special Purpose Vehicle, (SPV), to raise very large amount of capital far beyond what these countries can expect to generate through privatization or through direct investment. Also, in contrast to privatisation, securitization has the unique benefit of allowing all the benefits of raising huge amount of capital on comparatively better terms without mortgaging one’s industries and infrastructure to private buyers or lenders.[120]

2.11 Markets for Securitization

Elmgren[121] examines markets for securitization and submits that securitization has evolved in three primary investor markets; the public market, the private market and the commercial paper market, and that, each has its own characteristics and focusing on specific asset types.

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[120] ibid.

[121] K N Elmgren, ‘An Overview of Securitization’ in J J Norton, M S Dupler, and P R Spellman *International Asset Securitisation* (Lloyd’s of London Press Ltd, London, 1995) 1.

The degree of predictability of cash flow is the key determinant as to which segment of the capital market is more readily accessed by the originator through securitization.

2.12 "The Protection Gap" Conundrum

Being a complex financing transaction, securitization has been identified to be susceptible to what Schwarcz called "protection gap". The protection gap may be monitoring or protection gap in documentation. According to the scholar, in complex securitization transactions, parties may be unable or unwilling to pay the price of full protection and thus, they may elect or are forced to assume the good faith of other parties to the transaction and the consistency and completeness of protections provided in the transaction documents. He identifies and put to test two interrelated hypotheses: one, that the multitude of parties in securitization transactions creates collective action problems; two, that the complexity and novelty of securitization transactions undermine analysis. He submits that there certainly appears to be overreliance on trustees but that because securitization transactions are essentially financings, the trustee is not a traditional trustee but an indenture or a collateral trustee whose duties and obligations are exclusively defined by the terms of the indenture agreement.[122]

2.13 Credit Enhancement

According to Hahn,[123] every securitization requires that some protection be available to investors against losses on the underlying assets and the mechanism for this is referred to as credit enhancement. According to the commentator, credit enhancement comes in two forms: internal credit enhancement and external credit enhancement. Internal credit enhancement is

[122] S L Schwartz, *The Roberta Mitchell Lecture: Structuring Responsibility in Securitization Transaction* (n 115).
[123] R J Hahn (n 89).

done by way of the assets involved or the structure of the deal. Examples of internal credit enhancement are overcollateralization, senior/subordinated structure, excess spread or some combination thereof. On the other hand, external credit enhancement is provided by a third party, such as a letter of credit, an asset purchase agreement, a cash collateral loan or bond insurance.[124]

2.14 Key Legal Issues in Securitization

In a study by IFC Technical Working Group on Securitization in Russia[125] it was found that there are a number of key legal issues which arise in most securitizations and that a positive answer or a workable solution with respect to those issues is a prerequisite for a successful securitization. The issues listed are also stated to be the same that summarizes requirements that a legal system should meet for securitization to be legally feasible. The issues are:

i. Generally, only assets capable of being transferred can be securitised. Any obstacles to a valid transfer - such as prohibitions of assignment of receivables or data protection or banking secrecy rules, where these can prevent the validity of a transfer reduce the scope of assets eligible for securitization;

ii. Ability to effect a true sale: the sale and transfer of assets which are to be securitised should be irreversible. It should not be affected by an insolvency of the originator. Notably, it should not be subject to a re-characterization or insolvency claw-back;

[124] See K N Elmgren, (n 121) 16-17 who also states that credit enhancement can be internal to the transaction, that is, cash flow driven or external, that is, provided by a third party or originator's guarantee. The commentator also states that "though not true enhancement, a key component of the credit quality of a securitization is often the structural protections built into a transaction that serves to greatly mitigate the risks to investors". The credit enhancements identified are: Yield spread (excess servicing), Reserve Fund, Subordination, Overcollateralization, Recourse, Letter of Credit, Surety Bond and Structural Credit enhancement.

[125] IFC Technical Working Group on Securitisation in Russia Securitization; Key Legal and Regulatory Issues available at http://www.ifc.org/ifcext/eca.nsf/AttachmentsByTitle/Securitization1A%2B9-04/$FILE/Securitization1A%2B9-04.pdf last visited on 18 August, 2010.

iii. The transfer should not be overly costly or cumbersome. For instance, any cumbersome perfection requirements, such as the need to notify an obligor of the assignment in order for the assignment to be effective, or the need to register the transfer, may reduce the scope for securitization and increase transaction costs;

iv. Effecting assignments of receivables without notification to the obligor should be possible. The Originator should be allowed to service securitised assets for the Purchaser;

v. The Purchaser should be able to enforce its ownership rights with respect to securitised assets efficiently and should be allowed to appoint a Back-up Servicer if necessary;

vi. The parties should be able to enter into effective security arrangements, to provide credit enhancements, mitigate commingling risk and/or install a security trustee. Cash, bank accounts and marketable securities as well as securitised assets should be capable of being effectively pledged. The pledge should be capable of giving the pledgee an enforceable, first ranking right in the insolvency of the pledgor or Originator (or, as the case may be, Issuer). Enforcement of security must be transparent and relatively efficient;

vii. In order to achieve insolvency remoteness of the Issuer, limited recourse provisions and non-petition covenants agreed between the parties should be enforceable;

viii. Subordination arrangements should be enforceable. For instance, an agreement whereby the rights of Investors in a “junior” tranche of asset-backed securities are subordinated to the rights of Investors in "senior" tranches, should be enforceable in the insolvency of the Issuer;

Securitization should be capable of being effected in a tax-neutral way. Any transfer taxes or stamp duties, or similar levies increase transaction costs and make securitization less feasible. The participants should not suffer any adverse income tax or VAT consequences as a result of securitization.

2.15 Introduction of Securitization and Experience from Advanced Jurisdiction

Ma [126] provides an insight on how introduction of securitization can benefit from the experience in other jurisdictions, particularly, the advanced ones. Ma submits that developing China's housing mortgage-backed securitization will be significant in at least three respects: Firstly, decreasing the operational risks in commercial banks and increase in the assets liquidity in banks; secondly, improving the operational efficiency of China's real estate market and thirdly, motivating the security market and perfect the finance market system. Developing house mortgage-backed securitization in China is feasible because Mortgage Backed securities, (MBS), meets the basic demand for securitization as to the quality of assets and the housing MBS supported by house mortgage loans already possessed adequate asset scale and payment ability.

The commentator points out that series of measures adopted by the American Government to perfect the house mortgage loan mechanism and drive the development of securitization are:

[126] Y Ma 'A Discussion on Development of China's Housing Mortgage-backed Securitization and American Experiences' A.S.S (2008) Vol. 4 No. 4 April.

setting up of multilateral adjustment institutions; constituting a perfect legal system; providing favourable policy environment and exerting market's adjustment effect completely. Therefore, the inspiration of America's experience for China will be that: one, the government can use its powerful strength in system transformation to drive the development of housing mortgage primary market, constructing a market base for mortgage loan; second, the government should price the housing mortgage backed securities rationally; third, the government should constitute a favourable system and provide a nice policy environment; fourth, government should facilitate construction of special purpose vehicle for trust investment; and fifth, there should be regulation of China's credit ratng system.

The main problems in developing China's housing MBS are: one, that the property-right relationship is still unclear in China's real estate market because clear property-right is the base for both housing mortgage and mortgage-backed securitization and the long existence of unclear property-right will directly affect the demand for house mortgages in the primary market; two, there is shortage of officially guaranteed agencies in primary mortgage market and official issuing agencies in secondary market in China, which is not good for the decrease of risks in securities; three, more restrictions on security investors block the development of securitization; four, housing mortgage-backed securitization concerns a series of taxation and accounting issues, in which China is far from perfect. For example, in the taxation field, it is a must to avoid double taxation. In other words, the compound interests and the pure interests obtained by the security issuer should not attract taxes at the same time. Otherwise, the profits will be killed. However, China does not have relevant regulations in this field.

Ma concludes by submitting that developing MBS in China will be significant because it will decrease the operational risks in commercial banks, increase the assets liquidity in banks improve the operation efficiency in China's real estate market.

2.16 Justification for Priority of Security Interests

Security interests are crucial to asset securitization. Harris and Mooney[127] opine that securing a debt is similar to a vast array of voluntary transactions in which a debtor may dispose of its property. To them, creation of security interests is an incidence of exercising proprietary right they thus come forward with normative theory of secured transactions. This is predicated on the normative theories that justify the institution of private property. According to them, the legal regime for security interests reflects property law functionally and doctrinally. It, therefore, follows that the law should honour the transfer or retention of security interests on the same normative grounds on which it respects the alienation of property generally. The commentators further argue that for those that question secured transaction to prevail they must attack the generally applicable treatment of party autonomy in property and contract law or must explain why secured transactions differ from other transactions that the law respects.

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[127] S L Harris and C W Mooney, 'A Property-Based Theory of Security Interests: Taking Debtor's Choices Seriously' available at http://works.bepress.com/steven_harris/9 80 Va. L. Rev. 1994 2021.

2.17 Rating Agencies

Rating agencies play important role in securitization and structured finance generally.[128] According to Cetorelli and Peristiani,[129] rating agencies provide certification services to investors who need to carry out a due-diligence investigation of the underlying assets and evaluate the structure of the security. Ratings are necessary because many large institutional investors and regulated financial firms are required to hold mostly investment-grade assets.

The role of rating agency in securitization in the context of recent global financial crisis has also been considered in existing literature. Calomaris[130] points out that the failure of rating agency is evidenced in two respects. One is inflated ratings, which is the purposeful under-estimation of default risk on rated debts and the second is low quality ratings which are ratings based on flawed measures of underlying risk. It was pointed out that the recent collapse of subprime-related securitization revealed both problems in the extreme.

Calomaris submits that the belief by many policy makers that securitization sponsors are the constituency that control ratings is false. Rather, ratings exaggerating the quality of securitized debts were demanded by the buy side of the market who are the institutional investors whose portfolio purchases are attached to those purchases, because inflated ratings benefitted them. Such ratings are "helpful to institutional investors because they: (1) increase institutional investors' flexibility in investing, (2) reduce the amount of capital institutions

[128] According to Cetorelli and Peristiani, "The rating agencies played a critical role in the rapid growth of structured finance in the US over the past two decades". N Cetorelli and S Peristiani, 'The Role of Banks in Asset Securitization' FBNY Economic Policy Review/July 2012 47 at 49.

[129] ibid at 49.

[130] C Calomiris, 'A Recipe for Rating Reforms' available at http://astrid-online.com/Regolazion/Studi--ric/Archivio-22/Calomiris_Economists-Voice_11_2009.pdf last visited on 26 September, 2013.

have to maintain against their investments (the objective of re-remics alchemy), and (3) increase their perceived risk-adjusted profitability in the eyes of less-sophisticated ultimate investors…." Strong evidence that buy-side investors encouraged the debasement of the ratings process comes from the phenomenon of 'ratings shopping'. The evidence that rating shopping tends to produce a race to the bottom implies that the buy side favours the low-quality, inflated ratings that result from the race to the bottom. Calomaris thus submits that the recognition that the buy-side in the securitized debt market is the core constituency for low-quality and inflated ratings has important implications for reform in this area.[131]

2.18 The Role of Bank in Securitization

Securitization engenders disintermediation and this has brought up the issue of possibility of diminishing role of the traditional bank. Cetorelli and Peristiani[132] examines the primary roles in securitization process with a view to empirically demonstrate that the role of traditional bank has not diminished significantly because of securitization as it generally appears. The key roles in securitization process are undertaken by the issuer or originator, underwriter, rating agency, servicer, and trustee.

According to the commentators, focusing on the taxonomy of roles in securitization allows better understanding of the "shadowy" financial system of securitization and that structured finance retains all the unique facets of financial intermediation. They demonstrate that leaving aside rating agencies, securitization requires the primary services of issuer, trustee, underwriter, risk enhancer, and servicer. At the same time, banks perform exactly the same

[131] ibid.
[132] N Cetorelli and S Perisstiani, (n 128).

roles in the traditional model of intermediation: they are loan issuers and implicitly underwrite the loan portfolio to investors (the depositors and equity holders). They serve in the role of trustee as the delegated agent for their depositors and provide credit enhancement, represented by the existence of equity held on their balance sheets. They provide liquidity services, on both sides of the balance sheet, to firms and depositors. Finally, they act as servicer, collecting loan payments and paying interest to depositors.

Cetorelli and Peristiani conclude that financial intermediation has grown increasingly complex in recent decades. The system of financial intermediation, which traditionally had centred on banks simultaneously playing the many roles needed to guarantee an efficient match between supply and demand for funds, has become decentralized, and those roles can be played separately by more specialized entities. According to the commentators, this transformation in intermediation raises legitimate questions about the role of banks and the role of bank-based supervision and regulation, as systemic risk may be migrating out of the reach of regulators and policymakers. The commentators therefore submit that a proper assessment of financial intermediation's evolution and its now more complex characterization needs to be done through a proper quantification of the main roles - and thus potential new markets and entity types - involved in the process.[133]

Working on the basis of available data in analyzing in detail the system of asset securitization,[134] Cetorelli and Peristiani[135] submit that for the first time they were able to

[133] ibid.

[134] Which, according to the commentators, represents the core of the modern system of financial intermediation. The analysis focused on four principal functions of securitization: issuer, underwriter, servicer, and trustee.

[135] N Cetorelli and S Perisstiani, (n 128).

come up with a true quantitative mapping of which party does what along the crucial steps in the credit intermediation chain and conclud that although much of the securitization activity appears to have been done outside the regulatory boundaries of banking, there is strong evidence to the contrary. Again, the modern system of financial intermediation appears less complex than it did at first glance. Despite the multiple steps needed for a dollar of funding to reach its destination, the system still requires the same set of basic intermediation functions. However, when looked at closely, banking firms - identified according to their broader organizational structure - are still playing a central role. The commentators, therefore, recommend that these considerations should be relevant in any future assessments of the role of financial system supervision and regulation.

From the review of the existing literature, there are certain gaps in the existing literature which are identified. The gaps include absence of literature on rationale for and benefits of asset securitization in Nigeria, the adequacy or otherwise of the Nigerian law on priority and enforcement of security interests to support asset securitization, and legal risks and challenges of structuring asset securitization in Nigeria using the existing law. This research work addresses these gaps.

2.19 Summary

This chapter provides an overview of existing literature on asset securitization which are categorised under the following broad headings: meaning, types and definition of securitization; asset-backed securities; benefits of securitization; basic securitization transaction; asset securitization, capital market and financial disintermediation; merits of securitization over privatisation; markets for securitization; credit enhancement; justification for priority of security interests; key legal issues in securitization; banks and securitization; introduction of securitization and lessons from advanced jurisdiction; and structured finance and its regulatory challenges. The existing literatures around theoretical discussions of asset securitization were considered in Chapter One and to avoid repetition were not considered in this chapter.

Apparently because of the nascence of asset securitization and the fact that asset securitization is still untested waters in Nigeria, there is paucity of local literature in the area. Therefore, this study will fill the gap in existing literature as a seminal work on asset securitization and its challenges and prospects in Nigeria as well as relationship between asset securitization and security interests. Additionally, the study offers discussion of challenges of priority and enforcement of security interests as part of the necessary legal infrastructure facilitative of asset securitization.

Chapter Three

Promoting Asset Securitization in Nigeria: Issues, Challenges and Prospects

3.1 Introduction

As indicated in Chapter One, the focus of this study is to make a case for promotion of asset securitization in Nigeria while addressing the legal challenges and prospects for the utilization of asset securitization. It is, therefore, pertinent to consider issues of possible merits of utilisation of asset securitization generally and particularly in Nigeria as well as challenges and prospects of its promotion. Thus, this chapter will examine: the history of asset securitization; general consideration of merits of securitization; the utility of asset securitization in Nigeria; asset securitization and the Nigerian Asset Management Corporation of Nigeria (AMCON) Act; challenges and prospects of asset securitization in Nigeria; and summary.

3.2 History of Asset Securitization

Like most revolutionary concepts in our world, asset securitization was born out of adversity. After about a decade of boom, partially accentuated by the First World-War, the United States (US) economy led the global economy into an unprecedented depression in the late 1920s to the early 1930s. The pogrom started on 'Black Tuesday' October 29, 1929, the day the stock market crashed. Stock prices were on a free fall without any possible solution in sight. This led to a massive bank debt default and loss of millions of jobs. This was only the beginning, as many banks had invested customers' funds in stocks, the crash led to the closure of the affected banks. On seeing the possibility of more bank closures, people rushed to their banks to withdraw their deposits, thereby making the giant wheel of the economy grind to a halt. In

1934, as part of President Roosevelt's 'New Deal' programme, Congress passed the National Housing Act 1934 to create a secondary market in mortgages. This Act led to the establishment of the Federal National Mortgage Association in 1938 to provide liquidity to mortgage markets by purchasing mortgages when funds were low and selling when funds were adequate. The association is generally known as 'Fannie Mae'. In 1970 two further mortgage associations were established, namely the Government National Mortgage Association ('Ginnie Mae') through a privatisation of part of Fannie Mae and the Federal Home Loan Mortgage Corporation ('Freddie Mac'). Also in 1970, these associations started to trade mortgage-backed securities to the public.[136] These Congress backed entities, were insulated from the vagaries of private sector speculation and excessive drive for profit. They bought mortgages that have met certain criteria and sold off when the market condition stabilizes. This development led to what is now known as the 'sub-prime' sector.[137] Subprime mortgages are secondary level transaction on mortgage instruments.

Asset securitization, as we know it today, has not had a long history. The first asset securitization was carried out in 1977 in the US. It was an issue by the Bank of America, underwritten by Salomon Smith Barney. The first asset securitizations were aimed at improving the home loan market by increasing the funds available for loans to mortgage borrowers by US thrifts, which are similar to building societies.

[136] C L Peterson (n 22) 2191–2206.
[137] ibid.

3.3 General Merits of Asset Securitization

Asset securitization has been said to be as necessary to the economy as any organised markets are.[138] It helps in creating markets in claims that would otherwise have remained bilateral deals, reduces agency cost and thereby makes financial markets more efficient.[139] It also reduces the liquidity risk in the financial system by making financial assets tradable.[140] Asset securitization also disperses holding of financial assets, promotes savings and diversifies risks.[141]

According to Jobst,[142] securitization initially started as a way of depository institutions, non-bank finance companies and other corporations to explore new sources of asset funding either through moving assets off their balance sheet or raising cash by borrowing against balance sheet assets ("liquefying") without increasing the capital base (capital optimization) in order to reduce both economic cost of capital and regulatory minimum capital requirements (regulatory and economic motive).

The writer further submits that since its inception, securitization has gone a long way in advancing further objectives beyond being a regulatory arbitrage tool. According to him, it has developed into an efficient and flexible funding and capital management technique for both financial institutions and large corporations. It is an alternative and diversified market-

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138 V Kothari (n 6) 17.
139 ibid, 17.
140 ibid, 17. It was observed that liquidity-related problems have been responsible for a number of economic crises for instance, the Japanese and South-East Asian crises.
141 ibid, 17-18.
142 A A Jobst, 'A Primer on Securitization' available at: http://ssrn.com/abstract=832184 last visited on 15 May, 2015.

based source of refinancing economic activities which substitutes capital market-based finance for credit finance by disintermediation. According to him:

> The off balance sheet treatment of securitization also serves to diversify asset exposures (especially interest rate risk and currency risk), since the cash flow proceeds from the securitized asset portfolio are partitioned and restructured into several tranches with varying risk sensitivity. The generation of securitized cash flows also represents an effective method of redistributing asset risks to investors and broader capital markets (transformation and fragmentation of asset exposures). The implicit risk transfer of securitization does not only help issuers improve their capital management, but also allows issuers to benefit from enhanced liquidity and more cost efficient terms of high-credit quality finance without increasing their on-balance sheet liabilities or compromising the profit-generating capacity of assets. However, securitization involves a complex structured finance technology, which commands significant initial investment of managerial and financial resources.[143]

An attraction for asset securitization is that the originator is able to raise funds in the capital market by asset securitization at a lower cost than if it had borrowed the funds.[144] Two reasons have been adduced for the cost saving of raising finance through asset securitization. First, the originator avoids the intermediary's profit mark-up by raising funds without having to borrow from a bank or other financial intermediary. This is what is referred to as "disintermediation" and is akin to buying wholesale rather than retail. Second, there is usually interest-rate savings where securities are issued by a SPV unlike where securities issued directly by the originator. The interest-rate savings is said to reflect that financial assets are usually more creditworthy and always easier to understand and value than the originator itself.[145] Aside the foregoing, there are several reasons that make resort to securitization attractive to both non-financial and financial operators.

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[143] A A Jobst, *A Primer on Securitization* (n 142).

[144] S L Schwarcz, The 2011 Diane Sanger Memorial Lecture 'Protecting Investors in Securitization Transactions: Does Dodd-Frank Help, or Hurt?' 72 La. L. Rev. 591 2011-2012 downloaded from Heinonline (http://heinonline.org) Friday May 17, 2013.

[145] ibid.

Asset securitization has been described as the funding and risk transfer device suitable to a number of issuer and large corporate organisations that own suitable financial assets, be it a pool of debts or discrete revenue streams. For the banking system, asset securitization is said to avail the banking system lower solvability ratios and risks linked to financial sectors and regions and better financing conditions for companies and households.[146] Further, asset securitization has the benefit of allowing access to funding to the originator. This is even said to be a primary consideration for resorting to securitization.[147]

It allows the originator to obtain immediate fund for its receivables and this benefit of asset securitization ought to make it imperative for a serious consideration of its use in Nigeria. As can be seen from the recent past, billions of naira of the funds of Nigerian banks were tied down in unpaid loans and this definitely affected the liquidity of the banks. Were these banks able to resort to asset securitization, it would have been possible to obtain immediate funding against the huge receivables from loans and other advances to their customers. If the debt owed banks can be sold to others, then cash will be available for such banks to meet their own obligations. This should further enhance the probability of the buoyancy of financial institutions, as provisioning for bad debts would be reduced, if not eliminated and thus freeing resources for business, and enhancing profits. Therefore, the ongoing reform of the money market will be incomplete if non-performing assets, (or bad and doubtful debts), are not taken off the books of financial institutions. If this is done more money will be available for lending to deserving sectors of the economy, and the viability of recovery of technically insolvent

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[146] 'Structuring Securitisation Transactions' in the Netherlands available at http://www.pwc.com/gx/en/structured-finance/structuring-securitisation-transactions-in-netherlands.html last visited on 10 February, 2014.

[147] J V Robbe (n 11) 3.

banks and financial institutions will be greatly enhanced. This can be achieved by securitization of these assets and this will engender an increase in market activity.

Apart from being a source of funding, securitization has the potential for reducing funding cost. The cost of funding depends on the credit rating assigned to a debt obligation issued by an entity and rating, in the case of a corporate bond, will depend on the credit rating of the corporation.[148] Asset securitization achieves the benefits of cheaper funding "when the originator's credit rating is relatively low, and the notes backed by the originator's assets can be sold to capital market investors significantly cheaper as their creditworthiness is de-linked from that of the originator".[149] In securitization, the rating agency will assign a rating to each security based on the expected performance of the asset pool and the priority of a security in the structure hence the rating assigned to each security issued by the SPV will be independent of the financial condition of the originator company. The originator company can have "a speculative-grade rating but the Special Purpose Vehicle (SPV) can issue one or more securities with a much higher credit rating".[150] Therefore, notwithstanding the cost of credit enhancement and other legal and accounting expenses associated with a securitization, the behaviour of firms provides support that securitization is less expensive than the issuing corporate bonds. This benefit of asset securitization should also commend it to the Nigerian market as it will avail companies and even governmental entities opportunity to raise cheaper funding on the strength of their receivables, where requisite quantity and grade are available, irrespective of the credit rating of the entity.

[148] F J Fabozzi and V Kothari (n 11).
[149] ibid, 3.
[150] Ibid.

Another benefit of asset securitization is the diversification of funding sources. Thus, when an issuer establishes itself in the market, "it can look at both the corporate bond market and the asset-backed securities market to determine its best funding source by comparing the all-in-cost of funds in the two markets, as well as non-quantifiable benefits associated with securitization."[151] This possibility of diversification of funding source is attractive to an originator which bank unnecessarily restricts it in its funding requirements.[152]

Aside from the foregoing, the benefit of securitization may also be considered from the perspective of the relative merits of securitization over privatisation. For many years now, Nigeria has adopted the policy of privatisation of public utilities and institutions but with little or no success in terms of transformative economic and financial benefits. In this regard, Sholarin has submitted that while privatization has the potential to yield some economic benefits, it is not the best option for the countries in the emerging markets and that in so many cases it does not suit their economic, social and political conditions. According to the commentator most of these emerging economies lack adequate infrastructure with which to determine the market values of financial assets earmarked for privatisation. Consequently, privatisation has left many of these economies more vulnerable and poorer than they actually were before the exercise. The writer therefore proposed asset securitization as "a more sophisticated, modern, highly effective and prudent alternative" to privatisation for raising the capital so desperately required by the emerging economies. Securitization is said to have the potential to trigger radical transformation of economic landscape of emerging economies in

[151] ibid.
[152] J V Robbe (n 11).

that it is capable of attracting extremely large amount of capital than privatization under far more favourable terms and conditions. Furthermore, unlike privatization, securitization allows for leveraging, and it relies on different credit rating mechanism. The effect of this is to allow originator countries to tap into the global financial markets via an SPV to raise very large amount of capital far beyond what these economies can expect to generate through privatization or through direct investment. Also, in contrast to privatisation, securitization has the unique benefit of allowing all the benefits of raising huge amount of capital on comparatively better terms without mortgaging one's industries and infrastructures to private buyers or lenders.[153]

Also of importance to an emerging economy like Nigeria is that development of asset securitization can effectively address the problem of inability of the emerging economies to issue financial securities of their own due to extremely stringent measures and market conditions. This is because securitization enables the emerging economies to access global financial markets without having to issue securities of their own.[154]

The several benefits of securitization for emerging economies include but are not limited to: capability of attracting massive influx of capital from the global financial markets; enabling an issuer to raise capital up to and well beyond the accounting value of the issuers asset; cost efficiency compared to outright loans where penalties for late/deferred payment can cause

153 O Sholarin (n 119).
154 ibid.

capital amount to skyrocket within a few years;[155] improvement in the outlook of a country's balance of payments and put it on the path of meaningful economic growth with sustainable debt burden; usefulness in managing credit risk; lengthening maturities of their foreign debt and shielding them from excruciating penalties for rescheduling debts; originators are able to manage their finances more prudently and effectively as they are effectively immune against default or rescheduling risks.

Furthermore, asset-backed securitization has the potential to strengthen financial sectors of originator's economies and create jobs as well; securitization may also engender appropriate training and transfer of technical expertise by the consortium of issuers from the developed economies to the emerging market originators; and securitization makes it possible to transform a group of otherwise illiquid assets into tranches of very liquid financial assets with the attendant possibility of substantially enhancing the market value of financial instruments and making them more desirable for investors.[156]

3.4 Asset Securitization Post Global Financial Crisis

In making a case for introduction of asset securitization in Nigeria, one issue that must be immediately considered is whether asset securitization can be justified given the negative roles attributed to securitization in the recent global financial crisis.

In a developed economy like US, it has been noted that an increasing number of financial institutions employ securitization to transfer credit risk of the assets they originate from their

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[155] As was the case with Nigeria where sovereign debt of $19 billion in 1985 grew to $35 billion by the end of 2004 due to poor servicing and debt rescheduling.

[156] O Sholarin (n 119)

balance sheets to those of other financial institutions, such as banks, insurance companies, and hedge funds. These are done for various reasons among which are that it is often cheaper to raise money through securitization, and securitized assets were then less costly for banks to hold because financial regulators had different standards for them than for the assets that underpinned them. This 'originate and distribute' approach is said to have, in principle, brought broad economic benefits like spreading out credit exposures, thereby diffusing risk concentrations and reducing systemic vulnerabilities.[157]

It was, however, noted that the impact of asset securitization appeared largely to be positive and benign until the subprime crisis in US unfolded. In this connection, asset securitization has been said to be indicted by some commentators for compromising the incentives for originators to ensure minimum standards of prudent lending, risk management, and investment, at a time when low returns on conventional debt products, default rates below the historical experience, and the wide availability of hedging tools were encouraging investors to take more risk to achieve a higher yield. Furthermore, many of the loans were not kept on the balance sheets of those who securitized them, perhaps encouraging originators to cut back on screening and monitoring borrowers, resulting possibly in a systematic deterioration of lending and collateral standards.[158]

Also, as indicated in Chapter Two of this work, writers like Giron and Chapoy[159] clearly put the recent financial crisis at the doorstep of asset securitization. They remarked that securitization enabled the banks get rid of their portfolios of assets by issuing a variety of

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[157] A Jobst, *What is Securitisation* (n 11).
[158] ibid.
[159] A Giron and A Chapoy, (n 68).

securities investors bought. These loans are sold to banks and investment funds that can use them as collateral to apply for loans. The lenders no longer kept them on the accounting records of the original lenders making the lenders to distance themselves from the risk of payment default and this lowered the incentive to check the trustworthiness of the borrowers. However, when the subjacent assets fell into noncompliance, the crisis was precipitated. The commentators further submitted that the financial bailout by Central Banks show the errors of securitization and that at bottom, the current financial crisis puzzle goes beyond the fall of home prices or default by debtors and that its roots lies in speculation based on the expansion of securitization.[160]

Even before the financial crisis, there was concern about the propensity for the abuse of asset securitization. Schwarcz acknowledged that the collapse of Enron created a taint for asset securitization, particularly with serious abuse of special purpose entities in the Enron transactions. According to him:

> Because securitization transfers substantive risk away from the originator (to the SPV), it also facilitates off-balance sheet financing. This means that the financing raised by the SPV to purchase the financial assets need not be included as debt on the originator's balance sheet. Unfortunately, this raises a guilt-by-association: Enron's abuses relied heavily on the use of special-purpose entities and off-balance sheet financing. Although none of the troublesome Enron deals actually involved securitization and, as will be shown, there are very fundamental differences between those deals and securitization transactions, the fact that "the most common special-purpose entities" are SPVs used in securitization transactions creates a taint.[161]

Schwarcz, however, submits that there are several "fundamental differences" between Enron's abuse of SPV and securitization. Firstly, Enron used SPV for mere financial-statement manipulation but securitization is normally used to obtain lower-cost financing

[160] ibid.
[161] S L Schwarcz, *Securitization Post-Enron* (n 49).

through disintermediation. Secondly, unlike Enron, securitization unambiguously transfers risk from the originator to the SPV and its investors. Thirdly, a "most fundamental" difference between securitization and Enron's use of SPVs results from the presence of conflict of interest that pervaded Enron transaction and not from particular deal structure and that in contrast to Enron, management in securitization transactions would be expected to be free of material conflicts. Schwarcz believes that it is the absence of material conflicts that explain why actual securitization transactions have not raised any of the excesses found in Enron and other scandals. However, to forestall future securitization from giving rise to any such excess the writer suggests regulation to limit the existence of material conflicts in the transactions. Schwarcz goes further to submit that even the absence of excesses does not mean that securitization is desirable and thus proceeded to consider whether securitization is efficient and if the answer is in the affirmative, whether securitization is fair.

Rather than sounding the death-knell for securitization, the financial crisis has brought forward discussions of policies and regulations and policies to forestall future financial crisis. An important contribution in this regard is that of Caprio, Demirguc-Kunt and Kane. According to the commentators, the crisis was triggered by a sudden and widespread loss of confidence in securitization and financial engineering and by the manifest failure of respected statistical models for assessing and pricing credit risk. Also, the principal source of financial instability is not to be found in the aberrant behaviour of a few greedy individuals or in a sudden weakening of important institutions of a particular country at a particular time. According to them:

> Systemic financial fragility instead is marked by an undermining of effectiveness of financial regulation and supervision in every country of the world, often involving contradictory political and bureaucratic incentives. Supervisory institutions overlook when financial institutions and their customers overleverage themselves in creative ways, and also close their eyes to the unbudgeted costs of the loss exposures that excess leverage passes onto financial safety nets until it is too late for anyone to control the damage that results.[162]

Writing after the financial crisis, Caprio et al, while submitting that the development of securitization in emerging markets has not flourished at the same rate with the developing world because of underdeveloped capital market, conclude that securitization may be beneficial to the emerging markets like Nigeria if it is kept simple and well-regulated. So the challenge for Nigeria is to ensure that it derives the benefit of asset securitization by making it simple and well regulated. The commentators further counselled that a prudent framework for securitization should include two key features: "First, leverage should be effectively limited by capital requirements by requiring loan to remain on the banks' balance sheet. Second, loan origination should be straightforward and fully transparent".[163]

Drawing lessons from analysis of the financial crisis, Caprio et al, came up with some recommendations for authorities in developing countries to stem financial crisis from structured finance. One, is in the area of lender reform, by which compensation for loan officers must be linked to long-term performance rather than short-term profits and development of better information systems. Second is the reform of Credit Ratings Organisation (CRO), which should incorporate two main elements: (i) withdrawing government blessings from their work and (ii) improving CRO accountability for ratings

[162] G Caprio, Jr, A Demirguc-Kunt and E J Kane, 'The 2007 Meltdown in Structured Securitization: Searching for Lessons not Scapegoats' available at www.openknowledge.worldbank.org/bitstream/handle/10986/6309/WPS4756.pdf?sequence=1 last visited on 7 June, 2015.

[163] ibid 9.

decisions. Third is the reform of government accountability and advance planning in and out of crisis. There will be improvement of accountability where regulators establish and regularly test a well-publicized benchmark plan for crisis resolution. There is also the need to build the infrastructure that a modern financial system requires, more particularly a good information environment led by sound accounting and auditing, efficient contract enforcement, and clear incentives.[164]

Furthermore, it has been pointed out that there was nothing strikingly new about the mortgage related securities. According to Guseva,[165] transparency problems are typical in complex transactions involving multiple parties and that the mortgage-backed securities crisis of 2007-2008 merely exemplified another application of the same dilemma that are often corrected through extensive disclosure, reputational sanctions, market and regulatory monitoring, enforcement actions and, in certain cases, consumer protection legislation.

3.5 Possible Utility of Asset Securitization in Nigeria

Asset Securitization may also be of use to banks in reducing the regulatory reserve requirements. By section 45 of the Central Bank of Nigeria, Act 2007,[166] the Central Bank of Nigeria, (CBN), may from time to time, issue directives by circular requiring each bank to: maintain at all times in the form of cash reserves with CBN a sum equal to a prescribed ratio

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[164] ibid.

[165] Y Guseva, 'Evolutionary Developments in Mortgage Securitization: Financial Law Reforms, Putative Beneficiaries, and Archetypal Economic Risks' 21 Transnat'l & Contemp. Probs. 395 2012 downloaded and printed from http://heinonline.org on Friday May 17, 2013.

[166] Act No. 7 of 2007 published in Federal Republic of Nigeria Official Gazette No. 55 vol. 94 of 1st of June, 2007. (Hereinafter referred to as the CBN Act).

of the bank's deposit liabilities; hold a minimum amount of specified liquid assets which shall be expressed as a ratio of deposit liabilities of the bank; maintain a special deposit with CBN a percentage of the bank's deposit liabilities or a percentage of an increase or the absolute increase in such deposit liabilities over an amount outstanding on a date, and for a period as shall be specified by CBN. Asset securitization may be of benefit here where CBN recognises the transfer of the assets or the credit risk to the SPV as transfer of the credit risk of the relevant assets then the capital charge to those assets would not apply and the bank will then be able to apply the 'freed up' capital for other and more profitable purposes.[167]

In the context of Nigeria, to be able to get this accounting benefit, proper consideration will have to be given to the provision of Companies and Allied Matters Act 1990 on consolidation of accounts of holding and subsidiary companies.[168] Be that as it may, it has been pointed out that even though the argument is that, in asset securitization, the reduction of the amount of the originator's company on-balance-sheet can help enhance its return on equity and other key financial ratios, "it is probably reasonable to assume that today many equity and corporate debt analysts give recognition to both reported and managed (i.e.., reported plus off the balance sheet) leverage in their analysis of firms that utilize securitization...".[169]

The relevance of developing an asset securitization market in Nigeria can also be stated to be in the fact that National Pension Commission by its Regulation on Investment of Pension

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[167] J V Robbe (n 11) 4.
[168] See sections 336 to 338 of Cap C20, Laws of the Federation of Nigeria, 2010.
[169] F J Fabozzi and V Kothari (n 11).

Fund Assets, 2012[170] recognised in paragraph 4.3 of the Regulation that pension fund assets may be invested in "Asset Backed Securities including Mortgage Backed Securities. The requirements stipulated in paragraph 5 of the Regulation must be met.

Another area that Nigeria may benefit from securitization is in developing the mortgage market and addressing acute problem of housing and homeownership in the country. In the US, the first recognized securitization transactions took place in the early 1970s and involved pools of mortgage loans originated by savings and loans associations. From then, securitization has become the principal means by which banks and other mortgage lenders turn residential home mortgage loans into cash in order to make new residential home mortgage loans and expand home ownership in the US.[171] Asset securitization created liquidity by turning the cash flows from a pool of illiquid underlying assets (such as mortgages) into tradable securities and that liquidity created promise to make the financial system better diversified and more resilient. Moreover, the innovation has the gain of reducing cost of mortgages and more affordable home ownership for a range of marginally less-creditworthy individuals.[172]

Asset securitization may thus be of immense benefit in the area of home ownership and mortgage financing by way of mortgage backed securities in Nigeria. In mortgages by banks and some financial institutions for house purchases, the repayment is made in instalments over the life of the mortgage. However, by way of asset securitization in the form of mortgage

[170] Available at http://www.pencom.gov.ng/docs/1448884100_Regulation_on_Investment_of_Pension_Assets_2012.pdf last visited on 6th December, 2015.
[171] S L Schwarcz, *Protecting Investors in Securitization Transactions* (n 144)
[172] G Caprio, Jr, A Demirguc-Kunt and E J Kane (n 162).

backed securitization, the bank or financial institution will be able to sell the mortgage in an asset securitization deal to the SPV who then makes it possible for the bank or financial institution to have immediate access to funds by way of payment for the mortgages by the SPV through the proceeds of sale by the SPV of Mortgage Backed Securities and thereby the bank or financial institution is able to take on more lending for house purchases.[173]

Even though the benefits of asset securitization are many, the extent to which a country benefits from it is dependent on several factors including: the depth and breadth of national financial system, and level of its sophistication; the ways and manner that monetary policies are formulated, interpreted and executed; the robustness, consistence and coherence of the banking and commercial laws that governs securitization and other commercial transactions; the existence of experienced local legal practitioners with adequate level of experience and expertise with which to offer internationally sound legal interpretation of commercial and banking laws predictably and with good consistency; the prudence of fiscal and monetary policies embarked upon by the issuer-country; the form of receivables to be securitized; the type of originator (governmental entity, fund, corporate entity, financial institution,); the main reason for the securitization exercise. [174]

To the extent that sovereign loan and project finance can be the basis of asset backed securities, it may be argued that securitization may be relevant in the context of infrastructure development. According to Jobst, even though securitization was initially used to finance

[173] A Oteh, 'Capital Market As a Long Term Option For Financing Infrastructure Development' A Paper Delivered at the "Central Bank of Nigeria Infrastructure Finance Conference" held at the Sheraton Hotel and Towers, December 6 & 7 2010. Available online at: http://www.sec.gov.ng/files/Speech_infrastructure%20development%20-%20cbn.pdf, last visited on June 25, 2015. p 5.

[174] O Sholarin (n 119).

simple, self-liquidating assets such as mortgages any type of asset with a stable cash flow can in principle be structured into a reference portfolio that supports securitized debt and these can be mortgages, corporate and sovereign loans, consumer credit, project finance, lease/trade receivables, and individualized lending agreements.[175]

Nigeria is still faced with problem of infrastructure deficiency and this limits access to social services and significantly increases the cost of production and trade.[176] Access to finance is very germane in the development of the needed critical infrastructure. Asset securitization offers potential new capital to finance critical infrastructure and other project finance needs.[177] The explanation for this is that whereas commercial banks have traditionally acted as originators of project loans because they are able to evaluate complex project financing transactions and undertake the construction and similar risks that are usually involved in most project financing, they are usually limited in amount and closely monitor and control their project finance underwriting as a result of the short-term nature of a their liabilities. However, because the useful life of most project assets are quite long (20 or 25 years), the most appropriate long-term project debt capital is provided by life insurance companies given the long-term tenor of their financing and asset securitization is one mechanism for such refinancing. Thus, by refinancing a commercial bank's project finance loan or pool of such loans, the ability of the bank to originate and provide project finance loans is restored.[178]

175 A Jobst, *What is Securitisation* (n 11)
176 A Oteh (n 173) 1.
177 ibid, 6.
178 ibid, 6.

According to Otteh, the former Director General of the Nigeria's Securities and Exchange Commission:

> While experience in securitizing project finance is limited, there are examples to confirm that this form of finance can bridge the project financing "gap". In Hong Kong, China, Japan and Singapore, commercial and residential mortgage-backed securities dominate, while ABS dominate in Korea and throughout the region housing loans have tended to be the most consistent source of securitization based on the non-distressed assets, in part due to official support. Thus, housing finance was made part of public policy in Japan in 1950 (following the US); Malaysia 1985; Hong Kong, China from 1997; and Korea in 2004. Thailand's state Government Housing Bank is a substantial mortgage lender and has been planning an inaugural securitized issue.[179]

3.6 Asset Securitization and the Nigerian AMCON Act

There appears to be a statutory recognition of a structure akin to asset securitization under the Asset Management Corporation of Nigeria Act, 2010 (the AMCON Act), which was enacted to assist with the toxic or non-performing loan asset of banks in Nigeria. It must however be pointed out that unlike the situation under the AMCON Act, the utility of asset securitization is not about dealing with non performing or toxic assets of the originator. Asset securitization has been recognized as important in capital formation and the underlying assets in asset securitization is generally not toxic or not performing assets because in asset securitization, the investors in the asset backed securities issued by the SPV on the back of the receivables it purchased from the originators look to the yield from the underlying assets for repayment of their investments and its yield. This normal expectation will be defeated if asset securitization is predicated on toxic or non-performing loan assets. Generally, banks use asset securitization to transform intrinsically illiquid bank loans into securities that can be easily traded on the market through an SPV.[180] There is of course difference between illiquid nature of loans and

[179] ibid, 7.
[180] C. Peicuti (n 51) 445.

non-performing loans. The difference lies in the fact that non-performing loans are loans that are already going bad whereas illiquid loans are not yet realizable due to their tenor. In addition, almost all income yielding assets can be packaged for purpose of asset securitization but in AMCON only eligible assets by eligible financial institutions are qualified for AMCON transactions.

Notwithstanding, the first dissimilarity of asset securitization and transaction under AMCON Act as regards the subject matter as discussed above, there appears to be statutory recognition of a structure akin to asset securitization under the AMCON Act, 2010 to assist banks on the verge of collapse due to the weight of toxic non-performing loan assets. By section 1, the AMCON Act established the Asset Management Corporation of Nigeria (the Corporation) which by section 5(a) empowers the Corporation to acquire eligible bank assets[181] from eligible financial institutions[182] in accordance with the Act and by section 5(f) the Corporation is empowered to take all necessary or expedient steps to protect, enhance or realize the value of the eligible bank assets that the Corporation has acquired, including (i) the disposal of eligible bank assets or portfolios of eligible bank assets in the market at the best achievable price; (ii) the securitization or refinancing of portfolios of eligible bank assets, and; (iii) holding, realizing and disposing of collateral securing the eligible bank assets.

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[181] "eligible bank assets" is defined to mean "assets of eligible financial institutions specified by the Governor as being eligible for acquisition by the Corporation pursuant to section 24 of this Act" – section 61 of the Act.

[182] "eligible financial institutions" is defined to mean "a bank duly licensed by the Central Bank of Nigeria to carry on the business of banking in Nigeria under the Banks and Other Financial Institutions Act; and shall include a bank or other financial institution, whose banking license has been revoked by the Central Bank of Nigeria pursuant to the Banks and Other Financial Institutions Act"- section 61 of the Act.

There are some similarities between asset securitization and transaction under the AMCON Act and these are: in both transactions loan assets are transferred from the loan originator to some external entity, in the case of asset securitization, the SPV and in AMCON transaction, the Corporation established by the Act; and in both transactions, the entities to whom the loan assets are transferred may use the transferred assets to issue securities to recover the proceeds of the asset transferred.

There are, however, clear differences between asset securitization and AMCON transactions. In AMCON deal, the assets that are transferred to the Corporation are stated to be "eligible bank assets" of "eligible financial institutions". From the definition of the terms in section 61 of the Act,[183] it is clear that the transaction under the Act arises in the context of insolvency and/or liquidation of the banks, whereas in asset securitization, the originators are solvent entities and the asset class are not non-performing assets. The assets securitized are income-yielding assets of different categories not limited to bank loans and there must be some certainty as to the income from the assets which may not be the case under the AMCON deal. Also, there is no requirement for rating agencies in AMCON transactions as well as no credit enhancements.

3.7 Challenges and Prospects of Promoting Asset Securitization in Nigeria

In promoting asset securitization in Nigeria, first, it is important to emphasize the challenges of securing high quality securitizable asset for asset securitization to be efficient, cost effective and reliable. Next is the size and asset type of the receivables which must be such as

[183] Cap A24A Laws of the Federation of Nigeria, 2010.

to transform into an acceptable profit margin when securitized.[184] In Nigeria, the receivables assets of many banks and financial institutions, even though huge, are of very low quality.

There is also the problem of absence of adequate security interest backing these assets aside from the problems of cost and delay in enforcement and realization of security interests where debts are secured. Further to this, is the time-consuming judicial process of recovery of loans that has somewhat led to a culture of debtors being recalcitrant in fulfilling their debt obligations. In this regard, in promoting asset securitization in Nigeria, it is imperative to consider the adequacy or otherwise of the law of security interests in Nigeria, particularly in the area of priority and enforcement as these are crucial to possibility of realizing the receivables that underline asset securitization transaction. This will be the preoccupation of Chapters Four and Five of this work.

In considering the discussed possibility of utility of asset securitization in the area of mortgages and home ownership, it is pertinent to note that for asset securitization to emerge in the housing and mortgage sector in Nigeria there is need for further development of the mortgage market. Consequently, for asset securitization to work effectively in Nigeria, there should be a large-scale securitization of mortgage portfolios to create mortgage-backed securities for the secondary market. There is also the need for adequate regulatory framework. In addition, the Federal Mortgage Bank of Nigeria should become a major player in the primary and secondary markets to ensure access to adequate funding and create investor confidence in the Nigerian mortgage industry just as it is obtainable in the US (Fannie Mae

[184] O Sholarin (n 119).

and Freddie Mac) and other developed economies.[185] Happily, the Nigerian authorities have seen the need for increasing the liquidity within the mortgage sub-sector and availability of mortgage credit in Nigeria with the recent establishment of the Nigeria Mortgage Refinancing Company which was incorporated on 24th June, 2013 as Nigeria Mortgage Refinancing Company Plc and obtained approval-in-principle from the Central Bank of Nigeria on 20th June, 2013.[186]

Asset securitization is a structured financing transaction involving complicated and complex legal and regulatory issues which ought to be taken care of so that the investing public will not be negatively impacted. The legal and regulatory rules are often changing and evolving so far as the market is dynamic and various challenges and risks come up at every twist and turn. In promoting asset securitization in Nigeria, there will be need to consider the various aspects of necessary legislative and regulatory reforms to facilitate the transaction and ensure that the transactions are safeguarded so as not to become instrument of fraud in the long run to the detriment of the investing public. This is necessary in view of nascence of asset securitization in Nigeria and absence, for now, of any specific legal and regulatory framework for asset securitization in Nigeria.

3.8 Summary

The chapter considers issues of possible merits of utilisation of asset securitization generally and particularly in Nigeria as well as challenges and prospects of its promotion. The chapter

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[185] A Oteh (n 173), 7 - 8.

[186] See 'Overview of The Nigeria Mortgage Refinance Company (NMRC)' available at http://www.cenbank.org/Out/2014/CCD/Overview%20of%20the%20Nigeria%20Mortgage%20Refinance%20Compa , ny.pdf last visited on 18 April, 2014.

examines history of asset securitization. asset securitization post recent global financial crisis in view of the positions taken by some commentators of the role of securitization in the crisis, general consideration of merits of securitization, the possible utility of asset securitization in Nigeria, comparison between asset securitization and the Nigerian AMCON Act and some challenges and prospects of asset securitization in Nigeria.

On general benefits of asset securitization, the study finds that asset securitization: reduces agency cost; reduces the liquidity risk in the financial system; disperses holding of financial assets; promotes savings; and diversifies risks. Asset securitization, aside serving as regulatory arbitrage tool, has become an efficient and flexible funding and capital management technique for financial institutions and large corporations as well as an alternative and diversified market-based source of refinancing economic activities. It may also be attractive because the originator is able to raise funds in the capital market by asset securitization at a lower cost than if it had borrowed the funds.

On the positive impact of asset securitization on the banking system, the study finds that asset securitization avails the banking system lower solvability ratios and risks linked to financial sectors and regions and better financing conditions for companies and households.

The study submits that the benefit of asset securitization in allowing the originator to obtain immediate fund for its receivables ought to make it imperative for a serious consideration of its use in Nigeria. In this regard, it may assist in resolving liquidity problem of Nigerian Banks with huge receivables. It is further submitted that the on-going reform of the money market will be incomplete if non-performing assets, (or bad and doubtful debts), are not taken off the books of financial institutions and that asset securitization may assist in this regard.

The potential of asset securitization in reducing funding cost in the long run, the study submits, also commends it to the Nigerian market. Furthermore, aside finding that asset securitization has the benefit of diversifying funding sources, the study agrees with the finding that asset securitization may have relative merit over privatization. Asset securitization may also be of benefit to Nigeria as it can effectively address the problem of inability of the emerging economies to issue financial securities of their own due to extremely stringent measures and market conditions.

The study also considers the issue of whether in view of the role attributed to asset securitization in the recent global financial crisis, there is still justification to contemplate introducing asset securitization in Nigeria. The study finds that, notwithstanding the role attributed to asset securitization in the recent global financial crisis, asset securitization may be beneficial to the emerging markets like Nigeria if it is kept simple and well-regulated.

Asset securitization may also be of use to banks in reducing the regulatory reserve requirements. Also, when properly structured, it may also help in removing assets and liabilities off the balance sheet of the originator company; this is with a view to reducing pressures on its gearing ratios and capital adequacy calculations. Furthermore, National Pension Commission by its Regulation on Investment of Pension Fund Assets creates a window of investment that accommodates asset securitization. Development of the mortgage market and addressing acute problem of housing and homeownership in the country are other areas that Nigeria may benefit from asset securitization. Asset securitization may also be relevant in the context of infrastructure development as it offers potential new capital to finance critical infrastructure and other project finance needs. The chapter discusses the clear difference between asset securitization and AMCON transactions.

The study finds that some of the challenges that asset securitization will contend with is the requisite size and quality of receivables to support asset securitization as well as the problems of priority and enforcement of security interests considered in Chapters Four and Five of this study. The need to further develop the mortgage market for asset securitization to emerge in the housing and mortgage sector in Nigeria is also recommended in this chapter as well as the need for adequate regulatory framework for mortgage transaction.

It is finally recommended that, in promoting asset securitization in Nigeria, there will be a need to consider the various aspects of necessary legislative and regulatory reforms to facilitate the transaction and ensure that the transactions are safeguarded so as not to become instrument of fraud in the long run to the detriment of the investing public.

Chapter Four

Asset Securitization and Security Interests: An Assessment of Priority of Security Interests in Nigeria

4.1 Introduction

Essentially, both asset securitization and security interests allow persons or entities to raise funds at the back of some form of reliance on some underlying assets. However, asset securitization and security interests are clearly distinct from each other. The task of this chapter is to undertake an examination of concept of security, security interests and the relationship between security interests and asset securitization.

An effective security interests system is essential to the emergence and operation of viable asset securitization market. The research will undertake an expository and critical assessment of security interests system in Nigeria vis-à-vis the priority of security interest with a view to underscoring the need for reform of the security interests system as necessary step to promotion of asset securitization in Nigeria. The aspects of challenges of enforcement of security interests will be considered in Chapter Five.

4.2 Asset Securitization and Security Interests

In semblance to other concepts, 'security' "is incapable of an exact or precise definition".[187] Therefore, despite the obvious importance of the concept of 'security interests' to the law of secured transactions, the concept continues to evade precise definition".[188] According to Alli:

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[187] M A Banire, 'Documentation and Perfection of Securities in Nigeria' in E O Akanki, (ed), Unilag Reading in Law (Faculty of Law University of Lagos, Lagos, 1999) 126.

[188] P A U Alli, *The Law of Secured Finance; An International Survey of Security Interests over Personal Property* (Oxford University Press, New York, 2002) 15.

> The nature of security interests in common law jurisdictions remain uncertain. The term 'security' which is considered to be coeval with 'security interest', is also capable of describing transactions other than those in which property has been made available in support of the performance of an obligation. [189]

Goode, along the same opinion as Alli above, is also critical of the use of the term security.[190] Therefore, rather than defining security, Banire describes it as the further assurance given by way of creation of right in favour of the other party, towards the performance of an obligation.[191] Also, the general concept of security involves a transaction whereby a person to whom an obligation is owed by another person is afforded, in addition to the personal promise of the obligor to discharge the obligation, rights exercisable against some property of the obligor or a third party in order to enforce the discharge of the obligation.[192]

While the general concept of security may be said to be rights exercisable by a creditor to ensure that the obligation by a debtor is discharged, in the context of Nigerian law, which largely follows the English law position by the adoption of the common law,[193] a distinction may be made between security in the general sense and what kinds of security will constitute

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189 ibid, 16. According to Alli, "The principal example involves the use of 'security' to describe the whole panoply of instruments that are listed on a stock exchange…"

190 R M Goode *Commercial Law* (3rd edn. LexisNexis UK and Penguin Books, London 2004) 583. According to Goode: "The term 'security' is not ideal, since it is used in so many senses, being applied indifferently to describe the interest acquired in the asset, the instrument creating that interest and the asset which is the subject matter of the interest. It is also unhappily contiguous to 'securities' that is investment securities such as shares and bonds. There would be much to be said for substituting the word 'collateral'-despite our distaste for converting English adjectives into American nouns-but for the fact that in the securities industry the term is also used to include interests acquired by outright transfer under sale and repurchase ('repo') and similar sell/buy-back arrangement."

191 M A Banire, *Documentation and Perfection of Securities in Nigeria* (n 187) 127.

192 L O C Chukwu 'The Role of Court in The Enforcement of Securities' in I O Smith (ed), *Secured Credit in a Global Economy- Challenges and Prospects* (Department of Private and Property Law, Faculty of Law, University of Lagos, Lagos, 2003) 229.

193 See, I O Bolodeoku 'The General Principles of Law' in E O Akanki, (ed), *Commercial Law in Nigeria* (Revised edn, University of Lagos Press, Lagos 2007) 23-31 on received English Law as a source of Nigerian Law. See also A O Obilade *The Nigerian Legal System* (2003 Reprint, Spectrum Books Ltd, Ibadan 1979) 69- "The received English Law consists of the common law, doctrines of equity, statutes and subsidiary legislation". "The received English Law remains a veritable source of Nigerian law"- D Olowu and F Lasebikan (n 56) 245-6; N Tobi (n 56) 6, 17, 21-3.

security interests.[194] In this regard, a security interest is a right given to one party in the asset of another party to secure payment or performance by that other party or by a third party.[195]

There is distinction between a transaction under security interests and asset securitization, even though there appears to be some similarities between the two concepts. The similarities lie in the fact that the intended economic effect as opposed to the legal form of asset securitization is that the originator raises money from investors on the security of the receivables just as if it had granted a security interest over them.[196] The distinction lies in the fact that under a security interest, the secured creditor must return any surplus not needed for repayment of the secured loan to the debtor, but in asset securitization, the originator transfers the risk of non-payment of the receivables to the investors and removes the assets and the loan notes from its balance sheet.[197]

Fabozzi and Kothari also contend that while it appears that securitization achieves the purpose of financing, it does that in a unique way.[198] This is because, even though the end-result of securitization is financing, it is not financing as such, because, the entity securitizing its assets

[194] According to Sanni, a favoured approach is to define security in the context of 'security interest'- O Sanni 'Securities in a Global Economy: New Trends' in I O Smith (ed), *Secured Credit in a Global Economy- Challenges and Prospects* (Department of Private and Property Law, Faculty of Law, University of Lagos, Lagos, 2003) 24.

[195] L Gullifer, (ed), *Goode on Legal Problems of Credit and Security* (4th edn, Sweet & Maxwell, London, 2008) 11. According to Goode: "A fixed, or specific, consensual security interest possesses the following characteristics: (1) it is a right given by a debtor to a creditor in an asset; (2) the right is by way of grant of an interest in the debtor's asset, not by way of reservation of title to the creditor; (3) the right is given for the purpose of securing an obligation; (4) the asset is given in security only, not by way of outright transfer; and the agreement restricts the debtor's right to dispose of the asset free from the security interests". See also, O Sanni, (n 194) 24. See, generally, I O Smith, *Nigerian Law of Secured Credit* (n 1).

[196] P R Wood *Project Finance, Securitisations, Subordinated Debt* (2nd edn, Sweet & Maxwell, London, 2007) 112, para 6-001.

[197] L Gullifer (n 195).

[198] F J Fabozzi and V Kothari (n 11).

is not borrowing money, but selling a stream of cash flows that would otherwise accrue to it.[199]

According to Iacobucci and Winter:

> Asset securitisation is distinguished from a secured loan by the partitioning of the cash flows away from the rest of the firm in a "true sale" for bankruptcy purposes. Any explanation of asset securitisation must account for this key feature. If an issuance of securities based on subset of cash flows does not involve a true sale, then it is a secured loan, and the SPV would have a security interest but not ownership of the cash flows. [200]

Further, Iacobucci and Winter[201] posit that there are important differences between asset securitization and secured debt that make the former important as a distinct financing device. According to the commentators, securing debt does not insulate the firm from risky collateral to the same extent as securitizing does and secured transactions cannot limit managerial access to cash as directly as securitization does, particularly where the collateral in question is cash or where restrictions on the sale of the collateral are impractical. Further, secured debt transactions entail less incentive to value the collateral precisely, given that shortfalls and excess returns will generally be covered or realized in full by the borrower itself.

The conclusion is that there is a distinction between security interest and securitization. Part of this distinction also lies in the fact that securitization results in creation of asset backed securities.

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199 V Kothari, (n 6) 6. See also F J Fabozzi and V Kothari (n 11).
200 E M Iacobucci and R A Winter (n 23) According to them, this distinction is critical.
201 ibid.

4.3 Continuous Relevance of Security Interests

With the advent of structured financing transactions such as securitization, the issue of continuous relevance of security interests has not been free from controversy.[202] The position of Janger is that contrary to the apprehension of secured credit fans that bankruptcy legislation is a threat to secured lending, "the biggest threat to secured lending is asset securitization itself - and securitization is on the march". [203]

Janger's view appears extreme because securitization is not *per se* antagonistic to secured lending or security interests. Alli's view is preferable which is that, in view of the role of security interests in mitigating credit risk, coupled with the ability to carve up assets for the benefits of investors and other creditors, the importance of security interests has remained undiminished notwithstanding the emergence and growth of securitization. [204] Security interests also perform a vital role in more complex financing transactions, including project finance, securitization and structured finance.[205]

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[202] The issue is whether in view of the fact that conventional secured lending has come under considerable competitive pressure from alternative forms of fundraising, particularly securitisation, security interests has lost its relevance.

[203] See J E Janger (n 22) at 1760

[204] P A U Alli, *The Law of Secured Finance* (n 188) 7. It was pointed out that where fundraising is the predominant objective, borrowers should, in principle, be able to 'securitise' their assets without the need for an intermediated issuing entity (by using security interests to ring-fence the assets backing the issue of debt securities from the borrower's other assets). See also S Nasarre-Aznar and O Stocker 'Covered Bonds in Europe' in J J de Vries Robbe and P A U Alli, (eds), *Securitisation of Derivatives and Alternative Assets Classes* (Kluwer Law International, The Hague, 2005) 190-191.

[205] According to Alli: "These transactions often involve the establishment of special purpose vehicles (SPVs) to raise funds from investors in the capital markets through the issue to investors of tranched debt securities, with payment obligations represented by those securities supported by the 'horizontal partitioning' of the issuing vehicle's assets: the assets are the subject of a security interest in favour of the investors and the benefit of that security interest is shared by the investors in accordance with their differently ranked claims for principal and interest"- P A U Alli, 'The Law of Secured Finance' (n 188) 5.

In practice, security interests play a central role in whole business securitization[206] and inventory securitization.[207] Therefore, the proposition that security interest is a threat to securitization is far-fetched and security interests continue to be relevant in asset securitization.[208]

The significance of this submission is that the importance of an effective and efficient system of security rights system cannot be over-emphasized even in the context of utilisation of asset securitization. It is in this regard that this study shall focus on aspects of security interest system in Nigeria, particularly as it relates to priority and enforcement of security interests as same is germane to the evolution of a vibrant asset securitization market in Nigeria.[209]

4.4 Asset Securitization and Priority of Security Interests in Nigeria

The strength of asset securitization is the ability of the originator to raise immediate finance from the capital market on the strength of receivables whether secured or unsecured. Where the receivables is secured, the underlying security interests are usually assigned to the SPV and therefore, the realisation of the security interests will invariably be impacted upon by the applicable law on priority of security interests where a single property has been used as

[206] Whole business securitisation makes full use of the advantages of the common law floating charge , that is, the ease with which a single floating charge can be taken over the entire business assets of a borrower; and the ability of the holder of a floating charge, following the borrower's default or insolvency, to take control of the borrower's business and block the appointment of an administrator (in this context in the United Kingdom, by making use of the so-called 'capital market exception')- P A U Alli, *The Law of Secured Finance* (n 188) 7. See also P A U Alli 'Whole Business Securitisation' in S L Schwarz, *Structured Finance: A Guide to the Principles of Asset Securitisation* (Practicing Law Institute, New York, 2005) para 9:4.4.

[207] P A U Alli, *The Law of Secured Finance* (n 188) 7.

[208] The relevance of security interest in securitisation can be further exemplified in the development of corporate loan securitisation- See T W Albrecht and S J Smith 'Corporate Loan Securitisation: Selected Legal and Regulatory Issues' 8 DJCIL (1998) 411. Available at: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1266&context=djcil; last visited on 6th December, 2015.

[209] See A Basiru, 'Critical Evaluation of Perfection of Security Interests under the Nigerian Law' and A Basiru, 'Expository and Critical Analyses of Priority of Security Interest Under the Nigerian Law' (unpublished Ph.D. Seminar Papers 1 and 2 respectively) for expository and critical appraisal of perfection and priority of security interests under the Nigerian Law pointing to practical areas of needed reform of the Nigerian Law in these areas of secured credit transactions.

security. It is submitted that simple and straightforward priority rules are important in the evolution of Asset Securitization Market.

A single property may be used as security for several advances one created after the other because the value of property used as security usually exceeds the value of the indebtedness for which the security was created.[210] Where the value of the security exceeds the value of indebtedness, the debtor may use the same security for additional advances from other creditors and in this regard the issue of priorities may arise, particularly in the course of enforcement and realisation of the security. Therefore, the legal regime on priority may impact on availability to a debtor of the opportunity for creation of multiple security interest in an asset and the value of such security to lenders.[211] Priority is, therefore, crucial in determining the efficacy of any security structure in that a security interest may be valid, perfected and enforceable, it may prove ineffective due to priority of other interests particularly where available resources are insufficient to meet all claims.[212]

There is no gainsaying that the value of the security interest may depend on its priority.[213] While this does not mean that the subsequent security interests have no value but that each successive holders of the security interests must be satisfied and it is only when after this that the debtor retains sufficient equity in the asset to provide the required assurance to each junior

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210 Thus, in *George v. African Continental Bank Ltd*, 7 UILR 306, the court held it as anomalous that the value of the security was far below the indebtedness. According to the court: "It is also a matter of great concern that the bank should give a loan as much as N71,138. 00 on a security that is worth £3,000 i.e. going by Exhibit 'A' but which is even put as only N500.00 as revealed by evidence. My impression is that the bank officials have not been honest to their employers in respect of this particular transaction and have allowed so much money to be tied down on an insecure security."

211 Omotola has submitted that the necessity for a clearly defined and well-settled order of priority arises from the fact that most species of property are capable of accommodating two or more concurrent subsisting interests, which interests are in competition with or antagonistic towards one another; J Omotola, *The Law of Secured Credit* (Evan, Ibadan, 2006) 135.

212 O Sanni, Securities in a Global Economy: New Trends (n 194) 24, 41.

213 L Gullifer (n 195) 173-4.

incumbrancer.[214] Furthermore, priority affords a secured party control over the secured property in case the debtor runs into financial difficulties.[215]

Aside of the foregoing, a debtor may have contrived to borrow money in excess of the value of security or the secured property may have depreciated in value even though the value may initially be sufficient to support the debts of all the secured transactions. Where this is the case, and there is recourse to sale of the secured property, the rules of priority become relevant in determining the order of payment of the parties.[216]

Also, determination of priority will be relevant mortgages in deciding: which one of the several subsequent mortgagees is entitled to the title deeds on the discharge of a prior mortgage; which one of several mortgagees can requisition a transfer instead of a re-conveyance; and how a mortgage will be affected in an action for redemption or foreclosure.[217]

The issue of priority and its determination arises because of conflicting claims by two or more persons in relation to a property and from the foregoing, the issue of priority is not only crucial to the value of security but may, in fact, determine the accessibility of credit advances to debtors. The importance of rational, simple and coherent rules of priority of security interest cannot be overemphasised when the fact that credit advances is crucial to economic development of a society is taken into consideration.

[214] ibid 174.
[215] ibid 174.
[216] N P Gravells, *Land Law: Text and Materials* (Sweet & Maxwell, London, 1995) 812.
[217] E L G Tyler, *Fisher and Lightwood's Law of Mortgages* (9th edn, Butterworths, London, 1977) 429.

4.5 Theoretical Framework on Nature and Types of Priority Disputes

Goode[218] has identified four types of situations in which two or more conflicting claims are made to tangible or intangible personalty and the law has to determine which of the claims is to be accorded priority. One is where both parties claim an indefeasible title to the absolute interest in the asset. In this case, it is the winner that usually takes all because the upholding of one claim almost invariably destroys the other. Two, where both parties claim a defeasible title to the absolute interest as where two mortgages were created over the same asset in favour of two parties one after the other. In such circumstance, both parties have title but since the title is defeasible by repayment of the secured debt, the issue is one of priorities. Three, where one party claims title to the absolute interest and the other makes claim to a limited interest. Here the question is whether the ownership that is not contested is subject to the limited interest claimed by the other party and if the limited interest is upheld, it would mean that the ownership of the absolute owner is encumbered by the limited interest until discharged. Four, is where both parties claim a limited interest, for example, where the owner of a chattel charges it first to A and then to B. This situation is the same as the second situation such that the upholding of one claim does not destroy the other but merely subordinates it.[219]

According to Sykes and Walker,[220] the topic of priorities in the widest sense has to do with where the standing of a proprietary interest, whether of a security nature or not, is threatened not by anything defective in the internal transaction by which that proprietary interest is set

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[218] R Goode, *Commercial Law* (n 190).
[219] R Goode, *Commercial Law* (n 190) 52.
[220] E Sykes and S Walker, *The Law of Securities* (5th edn. The Law Book Company Ltd, North Ryde1993) 382.

up, but by the existence of an inconsistent or partially inconsistent interest vested in a third party.[221] The commentators submit that there are three types of questions. One is that there may be a priority issue in the "narrow sense", that is, "a balancing between the respective interests of two persons who purport to take from a common disponor by successive dispositions where there is nothing defective in the title of such disponor except for the fact that at the time of making one disposition, he or she has, or is argued to have, committed herself or himself to another disposition".[222]

Second is that there may be "a question which raises the issue of dependent or independent title".[223] In this instance, "the disponor has not committed herself or himself to two dispositions which have, as it were, to be measured against each other. The disponor has made but one disposition but the threat to the interest of the person who takes thereunder comes from some invalidity in the transaction was effected through gained title, for example, perhaps such transaction was effected through fraud, misrepresentation or illegality or perhaps the disponor was a purported agent acting without or beyond authority. The title of the disponee is threatened then by the existence of the third party from whom the disponor took her or his title".[224] Where a situation like this arises, it is the position of the commentators that the "question is whether the law will apply the historic rule of the common law of *nemo dat quod non habet* or whether it will find some rule which will suffice to postpone the interest of the third party and give the disponee a title independent of the third party and not one dependent on the superiority of the latter's interest".

[221] ibid 382.
[222] ibid 382.
[223] ibid 382.
[224] ibid 382.

The third is what Sykes and Walker call “paramountcy or indefeasibility”. They opine that the inquiry in this regard is “whether the interest of a later disponee will or will not rise superior to all prior interests, whether they arise from some creation by the disponor or are due to the weakness of the transaction by which the latter acquired title”. [225] According to the commentators, where paramountcy is held to exist, it will settle not only the issue of priorities in the narrow sense but also the issue of dependent-independent title.[226]

The commentators note that even though the validity of any distinction between the first and second situation above may be queried, it was submitted that:

> it seems that there is a true distinction between the question, for instance, whether a particular mortgagee takes subject to a prior created mortgage on the one hand and whether a buyer of chattels takes free of all prior infirmities in title because he or she bought in market overt on the other hand.[227]

Therefore, Sykes and Walker use the general words “priorities” to indicate “any situation where the interest of a security holder is threatened by dealings or interests which arise independently of the transaction by which he or she purports to take title”.[228]

According to Keinan, [229] most scholars agree that one of the major goals of secured transactions’ laws is to establish clear priority rules with respect to the underlying secured assets. Priority rules are, therefore, necessary where it is possible to have multiple rights on the same collateral and according to him, multiple rights may include secured, unsecured, and

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[225] ibid, 382.
[226] ibid, 382.
[227] ibid, 383.
[228] ibid, 383.
[229] Y Keinan ‘The Evolution of Secured Transactions’, World Development Report 2002: Institutions for Markets, Discussion Papers. Available at: http://www.worldbank.org/wdr/2001/bkgroundpapers/keinan.pdf 18; last visited on 17th May, 2013.

ownership rights.[230] The writer submits that there are two possible priority conflicts, that is, priority between secured creditors on the same collateral and priority between secured and unsecured creditors.[231] Distinction was therefore drawn between multiple possessory rights and multiple non-possessory rights. In the case of the former, the commentator submits that priority problems with respect to possessory rights are not a significant issue because it is likely that the creditors will know about each other, and therefore, will be aware of the priority problem.[232] It was submitted that in the case of non-possessory rights the possibility of having multiple rights is higher, since debtors can provide several rights (secured, unsecured, and ownership rights) to several persons, on the same collateral and that in that case, these persons may not know about each other and that this problem is one of the fundamental issues, which secured transactions' rules should solve.[233]

Apart from the problem of determining priority between secured creditors some other problems have to do with determination of the priority between secured and unsecured creditors, and between secured creditors and good-faith purchasers. According to Keinan, the most obvious problems are: what is the priority when we have both, secured and unsecured creditors, and the unsecured creditor is first in time; what is the priority when a good-faith purchaser is buying an asset, which has been secured to another person before?[234]

In the context of this work, focus will basically be on competing claims between rival claimants where two or more security interests have been created over the same secured

[230] ibid 18.
[231] ibid 18.
[232] ibid 19.
[233] ibid 19.
[234] ibid 19.

property. In some instances, the position of an outright buyer of a property in a competing claim against a secured creditor in respect of the same property may also be considered.

4.6 The General Rule; Temporal Order of Priority

Priority rules in Nigeria, like in England, are generally determined by rules of common law and equity to the extent that the rules have not been displaced by specific statutory provisions regulating priority in the context of the relevant transactions. Thus, a good starting point is to examine the issue of priority under the general law.

Generally, in Nigerian jurisprudence, temporal order of creation determines priority. In *Kachalla v. Banki*,[235] Musdapher JSC stated:

> "In property law, many different questions of priority may arise, these may concern rival conveyance of property or as in this case competing interests in the holding of the right of occupancy. The fundamental rule is that competing interests generally rank according to the order of their creation."

The temporal order rule is expressed as *qui prior est tempore portior est jure.*[236] The position of Gullifer is that the formulation that a person cannot in general transfer a better title than he possesses is usually used in relation to legal interest in goods while the formulation that as between competing interests the first-in time prevails is usually used in relation to competing equitable interests and interests in land.[237] The determination of priority would have been simple if the general rule was to be universally applicable but, as will be seen hereafter, the reality is that not only does the general rule admit of exceptions but the general rule is not

[235] [2006] 8 NWLR (Pt. 982) 364 at 375; [2006] LPELR-1640 (SC) 1 at 19.

[236] That is, the first in time is stronger at law. See, M Smith *The Law of Assignment* (Oxford University Press, Oxford, 2007) 416.

[237] See L Gullifer (n 195) 176; J Omotola (n 211) 95. See *Macmillan Inc v. Bishopsgate Investment Trust Plc* (No 3) [1995] 1 WLR 978; [1995] 3 All ER 747, 768, per Millet J.

universally applicable as it may be displaced by facts and circumstances of the transaction, nature of the transaction and the competing interests involved.

The problem of priorities of mortgages as security is closely associated to the fact that the issue of priority may depend on the legal or equitable nature of the estate or interest offered as security. According to Omotola:

> "The law of priority effectively lays down two large codes or rule systems for ascertaining priority, the application of which depends on whether the earlier mortgage over a legal estate in the mortgagor's land or merely a mortgage over an equitable interest. In other words, the definitive element in determining, which rule system should be applied is not the legal or equitable quality of the mortgage received by the lender, but rather the legal or equitable quality of the estate or interest offered as security".[238]

It is pertinent to also note that the conduct of the parties may be relevant in determining priorities where there are competing legal and equitable interests and where there are competing equitable interests but not where there are competing legal interests.[239]

As indicated above, there are exceptions to the general rule of first-in-time. An important exception is that a legal interest created for value and without notice of a prior equitable interest takes priority over that equitable interest.[240] This thus brings us to a discussion of the rule as regards bona fide purchaser of the legal estate for value without notice.

4.7 Bona Fide Purchaser of Legal Estate for Value without Notice

Generally, grantee of a subsequent legal security interests like a legal mortgagee will take the secured property subject to all existing equitable interests with the effect being that the legal

[238] J Omotola (n 211) 96. See also Sykes and Walker (n 220) 383.
[239] M Smith, (n 236) 421-4.
[240] H Beale, M Bridge, L Gullifer and E Lomnicka, *The Law of Personal Property Security* (Oxford University Press, Oxford, 2007) 418; Sykes and Walkers (n 220) 383.

mortgage will be subordinate to a prior equitable mortgage or charge.[241] This general position, which is still part of the first-in-time rule, will be displaced where the subsequent holder of the legal security interest is a bona fide purchaser for value of the legal estate for value without notice of the prior equitable interest.[242] In such case, the holder of the legal interest will take free from and have priority over the prior holder of equitable interest.[243] It is because of the protection afforded the bona fide purchaser of legal estate for value without notice that the acquirer of the interest is referred to as 'equity's darling'.[244]

The plea applies where there is prior equitable estate followed by subsequent legal estate.[245] Thus, in *Idehen v. Olaye*,[246] it was held that the principle cannot be invoked against a holder of a legal estate because it is a principle of immunity from an equitable claimant such as the respondent.

According to Sykes and Walker, the only ground for equity interfering with the legal estate is that the conscience of the holder is in some way affected and that this is not the case where the holder knows nothing of the fact that an earlier interest inconsistent with the one he or she has just taken exists and where there are no circumstances to put her or him on inquiry. While noting that the rule of non-interference with the bona fide purchaser of the legal estate has sometimes been treated as based on a lack of jurisdiction, the commentators submit that it is really not a question of jurisdiction but merely an instance of a case where the Court of

[241] P A U Alli, The Law of Secured Finance (n 188) 211.
[242] See Halsbury's Laws of England, 4th edn Vol 16(2) para 5.
[243] P A U Alli, The Law of Secured Finance (n 188) 211-2. *See Macmillan Inc v. Bishopsgate Investment Trust Plc (No 3) [1995] 1 WLR 978; [1995] 3 All ER 74*.
[244] M. Smith, (n 236) 418.
[245] Sykes and Walker (n 220) 386-7.
[246] [1991] 5 NWLR (Pt. 191) 344 at 354.

Chancery found no reason to interfere.[247] The essential requirements of the plea will now be examined in some details.

4.7.1 Acquisition of Legal Estate/Interest

A crucial requirement for the application of the rule is that the subsequent holder of the security interest that is seeking to be promoted over the earlier secured party holding equitable interest must have acquired the legal estate.[248] In *Animasahun v. Olojo*,[249] Obaseki JSC noted that even though courts of equity break in upon the common law, when necessity and conscience require it, they allow superior force of strength to a legal title to estate. Therefore, there must be a valid transfer/grant to a grantee claiming the plea of bona fide purchaser for value without notice.[250] In *Braimah v. Abasi*,[251] the instrument by which there was a purported sale to the Defendant was held a forgery. The Supreme Court held that there was no valid transfer to him and as such he was not a purchaser of the legal estate. The defence of bona fide purchaser of the legal estate for value without notice was not available to the defendant notwithstanding that he had no notice of the fraud perpetrated in the case.[252]

The emphasis on the acquisition of legal estate is, however, subject to qualifications. One, the plea may be raised where the purchaser acquires a superior right to call for the legal estate.[253]

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[247] Sykes and Walker (n 220) 387.
[248] See *Macmillan Inc v. Bishopsgate Investment Trust Plc* (No 3) [1995] 1 WLR 978; [1995] 3 All ER 747.
[249] [1990] 6 NWLR (Pt. 154) 111 at 122.
[250] *Braimah v. Abasi* [1998] 13 NWLR (Pt. 581) 167, 185.
[251] *Braimah v. Abasi*, supra.
[252] *Braimah v. Abasi*, supra.
[253] M I Jegede *Principles of Equity* (MIJ Professional Publishers Ltd, Lagos, 2001) 59-60.

The position of the law was stated by Stirling LJ in *Taylor v. London and County Banking Co.*,[254] that:

> Now, a purchaser for value without notice is entitled to the benefit of a legal title, not merely where he had actually got it in, but where he had a better title or right to call for it. This rule was laid down in *Wilkes v Bodington*. It has accordingly been held that if a purchaser for value takes an equitable title only, or omits to get in an outstanding legal estate, and a subsequent purchaser for value without notice procures, at the time of his purchase, the person in whom the legal title is vested to declare himself a trustee for him, or even to join as a party in a conveyance of the equitable interest (although he may formally convey or declare a trust of the legal estate), still the subsequent purchaser gains priority.

Although, the above proposition was adopted by the Privy Council in *Assaf v. Fuwa*,[255] the Board applied the *first in time rule* on the facts of the case. The court held that before the claim of a better right to call in the legal estate can displace the operation of the principle of first in time, the claimant must show that the owner of the legal estate either (i) had declared an express trust of the legal estate in his favour, or (ii) had joined in the conveyance to him of the legal estate, or (iii) had lodged title deeds with him. Thus, where there is no such positive act by the owner of the legal estate, a claim to a better right to call for the legal estate cannot be sustained. Chianu is of the view that the advice of Lord Porter in the case is "deep, attractive and seminal".[256]

A criticism that may be levied against this position that makes access to the defence dependent on the cooperation and some positive acts of the holder of the legal estate is that it may permit the holder to preferentially promote a holder of equitable interests over the others. However, the justification for the position lies in the fact of the insistence in equity to give preference to legal estate once there is no blameworthiness on the part of the acquirer of the

[254] (1901) 2 Ch 231, 262-3.
[255] (1954) 13 WACA 232; [1955] AC 215, PC.
[256] E Chianu, *Law of Sale of Land*, (Lawlords Publications, Abuja and Lagos, 2009) 429.

legal estate. Thus, there are enough safeguards in equity where there is some collusion between the previous holder of the legal estate and the party seeking priority position.

The second qualification on the requirements of legal estate is that a subsequent acquisition of the legal estate may suffice in certain cases where at the time of acquisition of the equitable interest the party had no notice of prior equitable interest.[257] This issue will be discussed under the section of this chapter on *tabula in naufragio*.

The third qualification is that the plea will be available without the legal estate against equities as distinguished from equitable interests.[258] Thus, in a contest between equitable interest and mere equities, a purchaser of an equitable interest[259] needs not obtain the legal estate before he takes free from prior mere equity[260] affecting the property.[261]

4.7.2 Bona Fide

Aside acquiring the legal estate, it must be shown that the legal estate was acquired bona fide. In *Animasahun v. Olojo,* [262] bona fide is defined as good faith, honestly, without fraud, collusion, or participation in wrongdoing. The issue of being a bona fide purchaser is closely

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[257] M I Jegede, (n 253) 60; *Bailey v. Barnes* (1894) 1 Ch.D 25.
[258] Halsbury's (n 242).
[259] Examples of equitable interests are estate contract- *Wright v. Dean* (1948) Ch.D. 686; equitable mortgages- *Rice v. Rice* (1853) 2 Drew 73; 61 ER 646; and a vendor's lien for unpaid purchase money- *Mackreth v. Symmons* (1808) 15 Ves. 329
[260] Examples of mere equities are: the right to have documents rectified or set aside for mistake *Garrard v. Frankel* (1862) 30 Beav 445; *Smith v. Jones* (1954) 1 WLR 1089; the right of a mortgagor to reopen a foreclosure order; the right to set aside a deed for fraud or undue influence - *Bainbrigge v. Browne* [1881] 18 Ch. D. 188.
[261] M I Jegede, (n 253) 60-61.
[262] [1990] 6 NWLR (Pt. 154) 111 at 122.

linked with that of notice and value.[263] Before dwelling on the issue of notice, we shall first examine the issue of value.

4.7.3 Value

It is an essential requirement for raising the plea of bona fide purchaser successfully that the purchaser must have given value for the acquisition. It is to be noted that the common law rule that the court does not inquire into the adequacy of consideration[264] is not applicable in making a determination whether a person is a bona fide purchaser for value.[265]

4.7.4 Notice

Aside from being a distinct requirement for a successful plea of bona fide purchaser of the legal estate for value without notice, presence of notice is a veritable ground for holding that there is lack of bona fide.[266] There are three kinds of notices: actual notice, constructive notice and imputed notice. Obaseki JSC, in *Animasahun v. Olojo*,[267] explained these three kinds of notices thus:

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[263] *Pilcher v. Rawlins* (1872) 7 Ch.D App. 259- "Such a purchaser, when he has once put in that plea, may be interrogated and tested to any extent as to the valuable consideration which he has given in order to show the bona fide or mala fides of his purchase, and also the presence or absence of notice."

[264] The general rule under the common law is that consideration need not be adequate but it must be sufficient and that even though consideration must be of some economic value to be sufficient, the value can be minimal- See G Samuel, *Contract Law: Cases and Materials* (1st edn. Sweet & Maxwell, London, 2007) 189. See also the Nigerian Cases of *Opara v. D.S. Nig Ltd* [1995] 4 NWLR (Pt. 390) 440 at 463; *African Petroleum Ltd v. Owodunni* [1991] 8 NWLR (Pt. 210) 351 at 414.

[265] Halsbury's (n 242).

[266] "The doctrine of notice lies at the heart of equity"- *Barclays Bank Plc v. O'Brien* [1993] 4 All ER 417, 429.

[267] [1990] 6 NWLR (Pt. 154) 111 at 122 – 123.

> Without notice: He must have no notice of the existence of equitable interest, he must have neither actual notice nor constructive notice nor imputed notice. A person has actual notice of all facts of which he has (or has had) actual knowledge however that knowledge was acquired. Constructive notice: The court of Chancery insisted that a purchaser should inquire about equitable interests with no less diligence that about legal interest which they could ignore only at their own peril. The motto of English conveyance is caveat emptor; the risk of incumbrances is on the purchaser who must satisfy himself by a full investigation of the title before completing his purchase. A purchaser would be able to plead absence of notice only if he made all usual and proper inquiries, and had still found nothing to indicate the equitable interest. Imputed notice: There is a third category of notice known as imputed notice. If a purchaser employs an agent, such as a solicitor, any actual or constructive notice which the agent receives is imputed to the purchaser.

The effect of notice is to destroy the "immunity".[268] In *Edokpolo & Co. Ltd v. Ohenhen*,[269] where the solicitor of a subsequent grantee made a discovery of an existing interest at the Land Registry, it was held that such a subsequent grantee could not be a bona fide purchaser.[270] Also, in *Bank of the North Ltd v. Bello*,[271] there was evidence that the lawyer to the respondent conducted a search at the Land Registry at Ilorin and that the search revealed that the land in dispute was registered at the Registry. The Court held that if the respondent's lawyer had conducted a search at the Land Registry in Ilorin, he would have come across the two deeds of legal mortgage executed by the appellant and Mr. J.O. Obasa and that the inference to be drawn from the existence of the two deeds of legal mortgage in the land Registry, Ilorin is that the respondent was untruthful in his evidence at the lower court that his counsel conducted the search or that the counsel was grossly negligent in the manner he conducted the search. In the circumstance, the court held that the respondent was not a bona fide purchaser.

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[268] Sykes and Walker (n 220) 387. See *Ohiaeri v. Yussuf* [2009] 6 NWLR (Pt. 1137) 207.
[269] [1994] 7 NWLR (Pt. 358) 511, 532.
[270] *Edokpolo & Co. Ltd v. Ohenhen* (supra) 532.
[271] [2000] 7 NWLR (Pt. 664) 244.

It is incumbent on a party raising the plea to show that he had no notice of the subsistence of the interest. That is, he must have no notice- actual or constructive or imputed.[272] Therefore, a subsequent grantee who failed to conduct a search at the land registry or conduct some form of enquiry cannot be heard to complain that he had no notice since a search or making such enquiry would have disclosed or brought to his notice a pre-existing interest.[273]

Statutory provisions on registration of certain interest have impacted on the doctrine of notice by reducing the ambit of instances where a party can claim not to have notice. For instance, it has been held that registration under Land Registration Law[274] constitutes a notice to all those who propose to have dealing or transaction on a certain piece of land.[275] Also, in *Bank of the North v. Bello*,[276] it was held that registration of a deed fixes the whole world with notice of it and that the subsequent grantee was deemed to have notice of an earlier registered deed of legal mortgage and as a result is not qualified to be a bona fide purchaser without notice.[277] However, publication in a newspaper as opposed to a publication in a Gazette is not presumed to be notice to the whole world.[278] However, as will be seen in our discussion on *tabula in naufragio*, notice will be immaterial where there are two competing equitable interest and one of the holders of the equitable interest has gone ahead to acquire a perfected legal title.

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[272] *Animasahun v. Olojo* [1990] 6 NWLR (Pt. 154) 111, 122-3; *Idehen v. Olaye* [1991] 5 NWLR (Pt. 191) 344, 354; See *Macmillan Inc v. Bishopsgate Investment Trust Plc* (No 3) [1995] 1 WLR 978; [1995] 3 All ER 747.

[273] *Idehen v. Olaye* [1991] 5 NWLR (Pt. 191) 344, 354; See, *Animasahun v. Olojo* [1990] 6 NWLR (Pt. 154) 111 at 121-123; *Jiwul v. Dimlong* [2003] 9 NWLR (Pt. 824) 154, 184-5; *Barclays Bank DCO v. Olofintuyi* [1933-1966] 1 NBLR 107.

[274] Cap 81 Laws of Bendel State, 1976. Other states in Nigeria have similar laws.

[275] *Idehen v. Olaye* [1991] 5 NWLR (Pt. 191) 344, 355.

[276] [2007] 7 NWLR (Pt. 664) 244, 258.

[277] See also *Akingbade v. Elemosho* (1964) NSCC 96, 100; *Amankra v. Zankley* (1963) 1 All NLR 304, 309; *Akerele v. Atunrase* [1969] NSCC 180 at 187 and *Ayinla v. Sijuwola* (1984) 1 SCNLR 410.

[278] *Idehen v. Olaye* [1991] 5 NWLR (Pt. 191) 344, 354.

4.7.5 Pleading of the Plea

The party claiming to be a bona fide purchaser must specifically plead same and where he fails, it will be presumed that he purchased with notice of the prior mortgage.[279] The practical effect of this is to make the issue of bona fide purchaser one of pleading.

There is some good reason in this position, in that, without raising the plea of bona fide purchaser in the pleading, the party whose priority is sought to be postponed may be caught by surprise and would not be availed of the opportunity to counter the issue of bona fide purchaser.[280]

4.8 Tacking of Further Advance

The issue of tacking of further advance arises where a first mortgagee will be able to retain priority in respect of further advance made by him subsequent to the creation of a second mortgage by the mortgagor over the same asset. It has been said that in the case of fluctuating credit exposure, a key concern for the secured party is ensuring that the priority-ranking enjoyed by it in respect of its existing exposure also applies to its future exposure and that this is what is known as the tacking of future advances to an existing security interest.[281]

The position at common law as to whether the right of the first mortgagee can tack further advance depends on whether the first mortgagee has notice of the second mortgage. Thus, the rule at common law is that a first mortgagee will be able to tack further advances and rank in

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[279] *Barclays Bank DCO v. Olofintuyi* [1933-1966] 1 NBLR 107.

[280] This is particularly so, in view of the position of the law that the aim of pleadings is to apprise the opposing party of the case the pleader is making so as to avoid any surprises at the hearing. See *Hanseatic International Ltd v. Usang* [2002] 13 NWLR (Pt. 784) 376 at 408; *Eze v. Attorney General River State* [1999] 9 NWLR (Pt. 619) 430, 446; *Olatunji v. Adisa* [1995] 2 NWLR (Pt. 376) 167 at 186.

[281] P A U Alli U, *The Law of Secured Finance* (n 188) 215.

priority to a subsequent mortgagee if the first mortgagee made the further advance without notice of the second mortgage[282] because notice of the second mortgage terminated the right to tack further advances.[283]

The effect of tacking of a further advance is to effectively increase the loan sum for which the earlier mortgagee may claim priority and thus tacking diminishes the real value of the security taken by the later mortgagee.[284] As regards its rationale, the rule restricting the ability to tack upon notice of the subsequent mortgage is considered necessary so as to avoid a situation where the first mortgagee will have a monopoly over the debtor's financing.[285]

In Nigeria, the position as to tacking of future advance will depend on the law of the state in question because it is the states law that regulate mortgage transaction. In states that have no equivalent provision to section 116 of the Property and Conveyancing Law (PCL), the above stated rule of common law continues to apply. However, in PCL states,[286] tacking of further advance is regulated by section 116 of the Property and Conveyancing Law.[287] Also, in Kwara State which also has a Property Law[288] patterned along the PCL, tacking is regulated by section 113 of the Law which provision is *in pari materia* with section 116 of the PCL.

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[282] L Gullifer (n 195) 179.
[283] *Hopkinson v. Rolt* (1861) 9 HLC 514.
[284] K Gray, *Elements of Land Law* (Butterworths, Dublin, 1993) 1038.
[285] L Gullifer (n 195) 180. H. Beale et al (n 240) 483- "There is nevertheless some force in the argument that the mortgagor will not be able to deal with his equity of redemption if he cannot vouchsafe priority to the second mortgagee over later discretionary advances made by the first mortgagee".
[286] Ekiti, Ogun, Ondo, Oyo, Osun, Edo and Delta States now have the Property and Conveyancing Law localised in the laws of each state even though still in *pari materia* with the Property and Conveyancing Law of Western Region on Nigeria.
[287] In *pari materia* with section 94 of the Law of Property Act 1925 (UK). The Property and Conveyancing Law is hereinafter referred to as the PCL.
[288] Cap P10, Laws of Kwara State, 2006.

Section 116 of the PCL generally abolished right to tack except as to the making of further advances as provided under the section.[289] The effect of the section is to modify the rule as to tacking of further advance at common law[290] as it is provided that a prior mortgagee shall have a right to make further advances to rank in priority to subsequent mortgages (whether legal or equitable): (a) if an arrangement has been made to that effect with the subsequent mortgagee; or (b) if he had no notice of such subsequent mortgages at the time when the further advance was made by him; or (c) whether or not he had such notice as aforesaid, where the mortgage imposes an obligation on him to make such further advances.[291]

It is to be noted that section 116 is not mandatory as a right to tack can arise out of a priority agreement between the two mortgagees.[292] The provision applies to both real and personal property and to debts incurred by both individual and corporate debtors but the applicability of the provision to personalty is not free from doubt.[293] It has been submitted that the section should be applied to personalty because there is no compelling policy reason why the section should be confined to land when on its terms it is capable of applying to personalty and that there is no reason why the tacking regime should differ as between land and personalty.[294] With respect, it is submitted that whether the provisions should apply to personalty is a matter of construction and interpretation of the provision and the issue of whether policy issue should be considered is *non sequitur*. Further, the issue of undesirability of having two separate legal regimes for land and personalty cannot justify making the provision applicable

[289] Section 96(3) of PCL, Cap 132 the Laws of Osun State of Nigeria, 2002.
[290] L Gullifer (n 195) 183.
[291] S 116(1) of PCL, Cap 132 the Laws of Osun State of Nigeria, 2002.
[292] S 116(1)(a) of PCL, Cap 132 the Laws of Osun State of Nigeria, 2002. H Beale et al (n 240) 487.
[293] H Beale et al (n 240) 481; L Gullifer (n 195) 183.
[294] H Beale et al (n 240) 488.

to personalty for the sake of uniformity of the law if the intention of the legislature as can be gathered from the statutory provision does not support such extension to personalty. It is submitted that there is nothing in the provision to justify the contention that it applies to personalty.

However, assuming that the provision is applicable to personalty, it is submitted that section 116(2) of the PCL which provides that a mortgagee shall not be deemed to have notice of a mortgage merely by reason that it was registered under the Land Instruments Registration Law if it was not so registered at the time when the original mortgage was made, whichever last happened, would not be applicable.[295] The effect of this will be that the right to tack may only be applicable to mortgages of personalty where the further advance is made by arrangement with the subsequent mortgagee or the first mortgagee is obliged to make it by the terms of the mortgage. But the right to tack will be lost where the previous mortgagee has notice of the subsequent mortgage, whether actual or constructive.[296]

As the circumstances under which the first mortgagee can 'tack' has been expressly provided under section 116 of the PCL, the first mortgagee falling outside the limits of tacking is subordinated to the second mortgagee to the extent of the former's further advances.[297] It has been observed that the issue of priority between the first and second mortgagees, both of whom make further advances presents a 'very odd feature, more intellectually intriguing, perhaps than practically important' in the operation of section 116.[298] Since section 116 does

[295] See L Gullifer (n 195) 184 on the rationale of section 96(2) in relation to mortgages of land.
[296] ibid186.
[297] H Beale et al (n 240) 487.
[298] ibid 487.

not constrain tacking by the second mortgagee, it may be contended that the second mortgagee would rank ahead of the first mortgagee in respect of further advances even if the second mortgagee's further advances were made after the first mortgagee's further advances. It has been submitted that this "is not a sensible outcome and is not made any more attractive by the prospect of the first mortgagee having notice of the second mortgagee's further advances being an unlikely one on any set of facts".[299] The sensible way out of the difficulty is to interpret the provision as subordinating the first mortgagee, in respect of further advances, to the second mortgagee only so far as the latter covers the original advance made by the second mortgagee and not any further advances by the second mortgagee.[300] It has been submitted that the section "prevents the first mortgagee from tacking, but beyond that act of disablement it does not go. If the first mortgagee can rely upon being the first in time with his further advances, then he has no need to rely upon the right to tack when faced with the second mortgagee's further advances."[301]

In view of the fact that section 116 only relates to further advances, then a first mortgagee who made initial advance after the creation of the subsequent mortgage will be caught by the rule in *Hopkinson v. Rolt*[302] and will be liable to have his priority postponed. It is thus a matter of prudence for the first mortgagee to conduct search before making his initial advance.[303] Further, it has been rightly suggested that the first mortgagee should be careful to ensure that he reserves in his mortgage instrument the right to exclude the rule in *Clayton's*

[299] ibid
[300] ibid
[301] ibid
[302] (1861) 9 HLC 514.
[303] L Gullifer (n 195) 184.

Case[304] for example by ruling off the debtor's account upon receiving notice of a subsequent mortgage and crediting later payments to a new account. This is because default to do this by the creditor will make the payment, under the rule in *Clayton's Case,* be applied in reduction of the earlier indebtedness first and thereby reducing that part of the debt as regards which the mortgagee has priority over the later mortgage.[305]

The provisions of section 29 of the Lagos State Mortgage and Property Law, 2012 is substantially similar to section 116 of the PCL and only differs from section 116 in two respects. One, by section 29(c), it is provided that the obligation on the mortgagee to make further advance "was noted in the register", a provision absent in section 116 of the PCL. Therefore, under the Lagos Law, for a prior mortgagee to make further advances to rank in priority to subsequent mortgages, the obligation to make the further advance must be noted in the register and the priority will be lost if the obligation imposed on the mortgagee by the mortgage is not noted in the register. Two, there is insertion of a subsection (2) in section 29 of the Lagos State Mortgage and Property Law which is not in section 116 of the PCL that tacking will only apply where the further advance does not exceed, with any other outstanding advance, the specified maximum amount secured under the prior mortgage which amount was noted in the register. It is submitted that the provisions of the Lagos Law is an improvement on the existing law on tacking of further advance.

[304] *Devaynes v. Noble, Clayton's Case* (1816) 1 Mer. 572.
[305] L Gullifer (n 195) 184.

4.9 Tabula in Nuafragio

This is an aspect of the rule that a legal interest acquired for value without notice overrides prior equitable interest. In view of the requirement that the time when the subsequent purchaser is required to be without notice is not when he takes the legal title but when he makes his advance,[306] the rule enables the holder of a later equitable interest who makes his advance without notice of the prior equitable interest to secure priority by getting the legal title if by the time he takes the legal title he has acquired notice of the prior equitable title.[307] Thus, in *Ejuetami v. Olaiya*,[308] it was held that an equitable mortgagee who has advanced his money without notice of a prior equitable mortgage may gain priority by getting in the legal estate unless the circumstances are such as to make it inequitable for him to do so. The court applied the case of *Taylor v. Rusell*[309] where it was also held that the mere fact that the subsequent incumbrancer has notice of the prior incumbrance counts for nothing. True, fraud may alter this position but the burden of proving fraud is on the party who alleges it.[310]

Tabula in naufragio has been considered to be a type of tacking[311] on the basis that it is the legal estate of the holder of the subsequent equitable interest that is "plank in a shipwreck, which rescues his equitable interest from its subordinate position to" the interest of the earlier equitable estate".[312] Gullifer's view is that the rule may only be applicable to a fixed charge because the interest of the holder of a floating charge is too nebulous to enable him to jump

[306] ibid 179.
[307] *Taylor v. Russel* [1892] AC 244; *Bailey v. Barnes* [1894] 1 Ch.D 25; L Gullifer (n 197) 179.
[308] [2001] 18 NWLR (Pt. 746) 572, 600-1.
[309] (1892) AC 244.
[310] *Ejuetami v. Olaiya* [2001] 18 NWLR (Pt. 746) 572, 605.
[311] H Beale et al (n 240) 489. It was described as "tacking of estates" by P A U Alli, The Law of Secured Finance (n 188) 218.
[312] H Beale et al (n 240) 489.

ahead of a prior fixed charge in getting in the legal title after notice of the fixed charge.[313] The commentator further stated that the *tabula in naufragio* is not available in the case of competing assignments of a debt.[314]

There is still some controversy as to the continuous existence of *tabula in naufragio*. Based on the provision of section 94 of the Law of Property Act, 1925 of the UK which is *in pari materia* with section 116 of the PCL,[315] there is the view that the tabula in *naufragio* has been abolished.[316] Beale and others have submitted that some uncertainty still remains over the continuing existence of the *tabula* in mortgage cases.[317] According to the commentators:[318]

> First, there remains some uncertainty about the application of section 94 to personalty: if the section does not apply, then the abolition of the tabula in the case of mortgages does not affect the mortgages of personalty. Further uncertainty stems from the failure of the Law of Property Act to define tacking. Again, the abolition of tacking may be contextually limited by the main subject matter of section 94, which is the making of further advance: the debtor is unaffected by the transaction between A and C and the case does not concern the action of a 'prior mortgagee' but rather the actions of the postponed second equitable mortgagee. The A-B-C example, moreover, should not fall within any possibly broader common-law statement of the doctrine exemplified by *Hopkinson v Rolt* itself, so far as such a doctrine survives section 94 of the law of Property Act 1925.

The commentators further submit that a final reason for expressing some doubt about the effect of section 94(3)[319] on the tabula comes from the statement of Millet J in *Macmillan Inc*

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[313] L Gullifer (n 195) 179.
[314] ibid.
[315] Cap 132, The Laws of Osun State of Nigeria, 2002.
[316] *Macmillan Inc v. Bishopsgate Investment Trust Plc* (No 3) [1995] 1 WLR 978, 1002- the *tabula* "[i]n relation to mortgages was abolished by section 94 of the Law of Property Act 1925"- Millet J. See also, P A U Alli, The Law of Secured Finance (n 188) 218; L Gullifer (n 195)183.
[317] H Beale, et al (n 240) 490.
[318] ibid.
[319] Section 116(3) of the PCL.

v. Bishopsgate Investment Trust Plc (No 3) that a version of the tabula continues to apply in the case of stocks and shares.[320]

What has been said about the effect of section 94 of the Law of Property Act, 1925 as regards the issue of abolition of the tabula and the attendant uncertainty will apply only in respect of the PCL states, Lagos and Kwara State. In all other States, the *tabula* remains unaffected in its common law formulation.

4.10 The Rule in *Dearle v. Hall* and Priority of Assignments of Choses and Receivables

The general rule on temporal order of priorities is not applicable to priority of competing assignments. Rather, the rule in *Dearle v. Hall*[321] applies. It displaces the rule that assignments rank in the order in which they were made and replaces same with a rule based on notice.[322] The rule is one of perfection and priority.[323]

The typical formulations of the rule is that it has two limbs; the first is that priority depends upon the order in which notice of the transfers or dealings was received by the person by whom the fund is distributable;[324] and the second is stated that an assignee who has actual or

[320] H Beale et al (n 240) 490. It was finally submitted that the recognition of the practice of mortgagees taking a pledge of share certificates, coupled with receipt of a completed transfer form accords with the needs of modern lending and that the fact that the practice is said not to fall foul of section 94(3) is commercially convenient – at 491.

[321] [1824-34] All ER Rep 28.

[322] M Smith, (n 236) 432-3. See also F Oditah, *Legal Aspects of Receivables Financing* (Sweet & Maxwell, London 1991) 130.

[323] The rule is a "special mode of perfection" available as regards security in a debt or other choses in action- R M Goode, *Commercial Law* (n 190) 583.

[324] See F Oditah (n 322) 130-131.

constructive notice of a previous assignment when he advances his money or acquires his security, cannot gain priority over that previous assignment by being the first to give notice.[325]

Although the second limb is a singular qualification of the first limb, a number of factors serve to qualify the rule.[326] It has thus been submitted that there is considerable authority to suggest that if the debtor knows of the first assignment at the time of the second assignment, even where such knowledge has not been derived from notice from the first assignee, the second assignee should not be entitled to take advantage of the first limb. This is because, when the second assignee comes to make inquiries, the debtor will be able to tell him of the first assignment.[327] In *United Bank of Kuwait v. Sahib*,[328]it was held that the second assignee must give value in order for his notice to ensure his priority.

4.10.1 Controversy as to the Scope of the Rule in *Dearle v. Hall*

There is serious controversy as to the scope of the rule in *Dearle v. Hall*. While there is no doubt that the rule regulates equitable interest in pure personalty and priority of successive equitable assignees of equitable chose, there may be controversy as to whether the rule applies where there are two equitable assignments of a legal chose in action and where one or both of the assignments are not equitable but legal.[329] Another area of controversy is as regards whether the rule applies to priority competition between a person interested in a chose

325 M Smith (n 236) 433. See F Oditah (n 322) 132-133.
326 M Smith (n 236) 433.
327 ibid, 443.
328 [1997] Ch.D 107, 119-20.
329 M Smith (n 236) 434.

by way of assignment and a person interested in the same chose by virtue of some other right like a tracing right.[330]

Oditah has submitted that there is wrong generalisation in stating that priority between competing assignees (whether legal or equitable) is governed by the order in which notice was given to, and received by the debtor. According to him, the rule is subject to important limitations. The rule does not apply to claims which arise by operation of law[331] and documentary receivables.[332] Besides, the notice to the debtor will not matter where the assignee has contracted not to give notice or where he holds a security which from its nature prevents any notice of claim given before the occurrence of future event from being effective as in the case of an uncrystallized floating charge.[333] Also, the two or more equitable assignments must be valid for the rule in *Dearle v. Hall* to apply because the only valid claim wins priority contest by default.[334] Furthermore, the rule does not apply where the assignor was never owed the receivables.[335] According to Oditah, this is an important qualification on the rule which if applied literally could emasculate it.[336]

Oditah has also submitted that the rule in *Dearle v. Hall* does not apply to a contest between two legal assignees of the same receivable because of two related reasons. First is the theoretical impossibility of having two legal assignments of the same debts at the same time. Second is that even where the prior legal assignment is for security only, and the assignor

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330 ibid.
331 F Oditah (n 322) 135.
332 ibid 136-7.
333 ibid 137.
334 ibid, 137. The decision in *E Pfeiffer GmbH v. Arbuthnot Factors Ltd* [1988] 1 WLR 150 was criticized.
335 *B.S. Lyle Ltd v. Rosher* [1959] 1 WLR 8.
336 F Oditah (n 322) 138.

retains an equity of redemption, since written notice is necessary for the acquisition of a legal assignment, that notice will be sufficient to ensure the continuing priority of the legal assignment.[337] Smith[338] has, however, subsequently submitted that despite some powerful arguments[339] to the contrary, it is now clear that the rule in *Dearle v. Hall* applies to legal assignments as much as to equitable assignments. The submission of Smith was predicated on the case of *E Pfeiffer Weinkellerei-Weineinkauf GmbH & Co v. Arbuthnot Factors Ltd*[340] which was considered and approved in the *Compaq Computer Ltd v. Abercon Ltd*.[341] It is submitted that Smith's the position is to be preferred.

4.11 Land Use Act and Priority of Land-based Security

In *Kachalla v. Banki*,[342] Musdapher JSC appears to take the position that the provisions of the Land Use Act 1978 (LUA) have rendered the distinction between legal estate and equitable interest inapplicable. With respect, this position is not maintainable. The fact that the maximum interest that a person can have under the LUA is the right of occupancy has nothing to do with the issue of whether the right or interest in the right of occupancy is legal or equitable interest. In fact, section 22 of the LUA expressly recognised equitable mortgage over a right of occupancy. It is submitted that Musdapher JSC's statement is in total neglect of the possibility of further relationship between the holder of right of occupancy and third

[337] ibid 139-140.
[338] M Smith (n 236).
[339] Like that of Oditah (n 332).
[340] [1988] 1 WLR 150.
[341] [1991] BCC 484.
[342] [2006] 8 NWLR (Pt. 982) 364 at 383.

parties, for example, creation of an equitable mortgage with the land that is subject matter of right of occupancy as security for a loan.[343]

Consent of the Local Government or the Governor is required under the LUA for qualifying security transaction on land and this includes, basically, legal and equitable mortgages.[344] While the LUA provisions on consent is not meant to regulate priority of security interests it may be useful to consider the possible impact of the provision on priority of secured parties.

Where there is contest between two mortgagees over the same property and it is only one of the mortgagees that received consent, then, irrespective of the purported order of creation, the only valid mortgage will be the one that has consent. Therefore, there will not be a real priority contest in view of the fact that one of the mortgages is null and void due to absence of consent.

But then there may be a situation where consent was given to several mortgages in respect of a single property because there is no provision in the LUA prohibits consent to be given to several mortgages in respect of one property.[345] The issue may then be raised as to whether the temporal order for the creation by parties or the grant of consent is determinative of priority of the mortgages. Were the first-in-time rule to be applicable, then the date of execution and not consent will be determinative because, upon grant of consent, valid and

[343] See I O Smith, Sidelining Orthodoxy in Quest for Reality: Towards an Efficient Legal Regime of Land Tenure in Nigeria (University of Lagos Press, Lagos, 2008) 15-16 for criticisms of the decision in *Kachalla v. Banki*.

[344] Sections 21 and 22 of the Land Use Act prescribe the requirement of consent of the Local Government or the Governor for any form of alienation of right of occupancy and the effect of failure to obtain consent is to render the transaction null and void- Section 26, Land Use Act. *Calabar Central Cooperative Thrift v. Credit Society Ltd Ekpo* (2008) 33 NSCQR (Pt. II) 1146; (2008) 1-2 SC 229.

[345] Section 48 of the Act preserves all existing laws relating to the registration of title to, or interest in, land or the transfer of title to or any interest in land shall have effect subject to such modifications (whether by way of addition, alteration or omission) as will bring those laws into conformity with the Act or its general intendment.

binding mortgages can be said to have been created dating back to the date of execution in view of the position that the transaction is inchoate upon execution and before consent is given.[346] However, this is not the case because the two transactions having been duly consented to are valid and priority is then to be determined under the relevant registration/property legislations which are expressly preserved by section 48 of the LUA. In this regard, the suggestion that there should be a register for Governor's consent issued[347] is unnecessary and fails to take into cognizance the necessity for registration and the consequence thereof.

4.12 Priority under the Land Instrument Registration Law

Land-based security transactions that have received consent require registration either under the Land Instrument Registration Law[348] or Lagos State Lands Registration Law[349] for the purpose of priority. Section 16 of the Land Instrument Registration Law provides that every instrument registered under the

Law shall, "so far as it affects any land, take effect, as against other instruments affecting the same land, from the date of its registration…". The practical implication of the provision of section 16 is that the first to be registered, even though it is the last to be executed, is preferred where there are counter claims.[350] That this is the case is reinforced by section 119

[346] *Awojugbagbe Light Industries Ltd v. Chinukwe* [1993] 1 NWLR (Pt. 270) 485.

[347] K Oluwajana 'The Land Use Act and The Banking Industry' in O Adigun (ed), The Land Use Act; Administration and Policy Implication (University of Lagos, Lagos 1991) 113, 117.

[348] The law originates in the Land Instrument Registration Act, 1924. The Land Instrument Registration Act started as a federal statute but became a regional law upon adoption of federal constitution in 1854. The legislation is now states' law and almost every state has its own version of the Land Instrument Registration Act. The provisions of the states' law are, however, similar.

[349] Law No. 1 of 2015.

[350] J Omotola (n 211) 68. See also, *Amankra v. Zankley* (1963) 1 All NLR 304.

of the PCL[351] which provides that every mortgage affecting a legal estate in land made after the commencement of the law, whether legal or equitable, shall rank according to its date of registration under the Land Instruments Registration Law.[352] However, the provision does not apply to mortgages or charges of land registered.[353]

The import of section 119 of the PCL has been stated to be that priority is to be determined strictly by date of registration. Thus, a subsequent purchaser with notice of earlier unregistered mortgage will be preferred if he is the first to register. The position is the same where competition is between instruments creating equitable and legal mortgages. To hold otherwise may be defeating the requirement for registration.[354]

It may be noted that section 116 of the Kwara State Property Law[355] provides that every mortgage affecting a legal interest in land made after the commencement of the law, whether legal or equitable, shall rank according to its date of registration under Part XVII of the law. However, there is no part XVII in the Law as the Law only has part I to part XI. It is submitted that this is a serious error in the Law as the date of registration has no reference point. It is hoped that an urgent amendment will be made to make the provision intelligible and practicable.

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[351] Applicable in Ogun, Ondo, Oyo, Osun, Ekiti, Edo an Delta States.
[352] Section 99, Property and Conveyancing Law, Cap 132, Laws of Osun State.
[353] Proviso to section 99, Property and Conveyancing Law, Cap 132, Laws of Osun State. The position as to priority under the Lagos State Lands Registration Law is discussed later.
[354] M I Jegede (n 253) 73-4.
[355] Cap P10 Laws of Kwara State, 2006.

4.13 Priority under the Lagos State Lands Registration Law

The Lagos State Lands Registration Law, 2015[356] with the commencement date of 21st January 2015,[357] is the applicable law to the registration of every documents of interests or title to land in Lagos State.[358] The LSLR Law repealed the Registered Land Law,[359] Registration of Titles Law and Registration of Titles (Appeals) Rules,[360] Land Instruments Registration Law[361] and the Electronic Documents Managements System Law 2007.[362]

Section 29(1) of the LSLR Law provides that subject to the provisions of section 29, documents creating interests in the register shall irrespective of their dates have priority according to the order in which they were presented for registration. The issue here is when will a document be said to have been presented for registration. It is submitted that a document is presented when it is delivered at the registry. Section 29(2) of the LSLR Law provides that documents for registration may be delivered by hand, post or courier and the document shall be registered on that day if it is delivered at the Land Registry within the hours of registration. But where the document is not delivered within the hours of registration, it shall be registered at the commencement of the next working day. It is pertinent to note that by section 29(3) of the LSLR Law, where two or more documents are sent separately by post or courier in respect of the same transaction, they shall be deemed to have been received at the Land Registry at the time the last document was received. However, where the Registrar

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356 Law No. 1 of 2015. Supplement to Lagos State of Nigeria Official Gazzete Extraordinary No. 8 Vol. 48 of 2nd February, 2015- Part A. Hereinafter referred to as the LSLR Law.

357 Section 123 of the LSLR Law.

358 Section 2 of the LSLR Law.

359 Cap R1 Laws of Lagos State 2003.

360 Cap R4 Laws of Lagos State 2003.

361 Cap L58 Laws of Lagos State 2003.

362 See section 122 of the LSLR Law.

is of the opinion that a question of conflict of interest has arisen between any of the documents mentioned in section 29(3), he may refuse registration until he has heard and determined the right of the parties interested in the documents.[363] Where a document is prepared by the Registrar, the document is deemed to be registered on presentation of an application and shall have the effect of registration.[364] It is, however, not clear from the law by whom is the application to be made.

Section 30 of the LSLR Law provides for effect of non-registration, apart from the loss of priority implicated by section 29. Section 30 of the Law provides that no registrable instrument shall be pleaded or given in evidence as affecting land in the State unless it has been duly registered.

4.14 Priority and Voidable Dispositions

Section 181 of the PCL[365] may also be relevant in a priority dispute. It provides that every conveyance of property made with intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced but that the section does not apply[366] to any estate or interest in property conveyed for valuable consideration and in good faith to any person not having, at the time of the conveyance, notice of the intent to defraud creditors.[367]

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363 Section 29(4) LSLR Law.
364 Section 29(4) LSLR Law.
365 Cap 132, The Laws of Osun State of Nigeria, 2002.
366 Section 181(1) Cap 132, the Laws of Osun State of Nigeria, 2002.
367 Section 181(2), Cap 132, the Laws of Osun State of Nigeria, 2002.

A successful invocation of section 181 (1) of the PCL may earn a secured party priority that would otherwise have been postponed. However, in *Olofintuyi v. Barclays Bank DCO,*[368] it was held by the Supreme Court that the Bank has not shown, on the evidence in this case, that it has been prejudiced, so as to have any right to have the conveyance set aside under section 181 of the PCL.

4.15 Subsequent Transaction Being Void

It would appear that a subsequent legal transaction that would otherwise have priority over an earlier equitable transaction will not acquire the priority where the subsequent transaction is held to be void and of no effect.[369] In *National Investment Co Ltd v. Bank of West Africa,*[370] it was held that a subsequent assignee that was registered as owner under the Registration of Titles Act did not acquire any right of priority over the earlier equitable mortgage because the subsequent assignment was null and void as the assignee was not an incorporated entity as at the date of registration.

It is submitted that the converse will also be the case where a transaction that would otherwise have priority on a first-to-create basis is held to be null and void. There cannot be a valid

[368] [1965] 3 NMLR 142. The judgment of the trial court in *Barclays Bank, DCO v. Olofintuyi* [1961] All NLR (Pt. 3) 828 was set aside.
[369] *National Investment Co Ltd v. Bank of West Africa* [1933-1966] 1 NBLR 214
[370] [1933-1966] 1 NBLR 214 (FSC).

priority contest between a subsequent valid transaction and the prior transaction that is null and void.[371]

4.16 Priority of Security Interests in Companies

Section 197 of the Companies and Allied Matters Act 1990 (CAMA)[372] provides for registration of company charges. This provision, however, does not regulate priority. Priority of company security interest is regulated by relevant provision of CAMA[373] and the general law.[374] Any special rules prescribed by other legislation for the particular type of assets in question may also be relevant in determining priority.[375]

Priority of company charges is normally determined by the date of creation and not date of registration.[376] Therefore, where there are two competing interests with both registered within 90 days,[377] the priority of the two competing registered interests is to be determined according to the date of creation and the earlier created interest will normally have priority even though the grantee of the latter interest had no means of discovering from the register the existence of the prior charge.[378]

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[371] In this regard, the previous discussion in this paper on the possible effect of the Land Use Act on priority contest in land-based transaction becomes apposite.

[372] Cap C20 Laws of the Federation of Nigeria 2010. Hereinafter referred to as CAMA.

[373] See section 179 of Cap C20 LFN 2010.

[374] I O Smith (n 1) 316.

[375] R Goode, Commercial Law (n 190) 662.

[376] K Ajayi 'Bull In The China Shop: A Comparative Analysis of the Two Commonwealth Charges' in O Ajayi (ed.), *Legal Aspects of Finance In Emerging Markets* (LexisNexis Butterworths, Durban, 2005) 483. According to Goode, registration of the security interest is merely a perfection requirement, it does not validate an ineffective security and it does not constitute a priority point. He writes: "registration does not guarantee priority; it merely serves negatively to prevent avoidance of the security as against subsequent encumbrancer"- R Goode, Commercial Law (n 190) 662.

[377] Section 197, Cap C20 LFN 2010.

[378] R Goode, *Commercial Law* (n 190) 662; K Ajayi (n 376) 483.

Be that as it may, there is specific provision in CAMA as regards priority of fixed and floating charges.[379] Therefore, as will be hereafter discussed, the nature and characterisation of the charge, that is, whether fixed or floating, may also be determinative of priority irrespective of the date of creation and registration.

4.17 Priority of Fixed vis a vis Floating Charges

The relevant section in determining priority between fixed and floating charges is section 179 of CAMA[380] which re-emphasises the common law principle that a fixed charge ranks in priority over a floating charge.[381] Thus, irrespective of the temporal order of creation, a fixed charge has priority over a prior floating charge except in the circumstances provided in section 179 which are: (i) that the terms on which the floating charge was granted prohibited the company from granting any later charge having priority over the floating charge; (ii) that the person in whose favour such later charge was granted had actual notice of that prohibition; and (iii) that the grantee of the later charge had actual notice at the time when the charge was granted to him. Where these conditions exist, the general presumption of priority of fixed charge will be postponed in favour of the floating charge.

An argument may be made that it may reasonably be presumed that a company must have taken a floating charge and thus that it behoves the fixed chargee to make enquiries otherwise notice should be imputed in which case the onus of proof of lack of notice and the standard

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[379] Section 179 Cap C20 LFN 2010.

[380] Section 179 of CAMA provides that a fixed charge on any property shall have priority over a floating charge affecting that property, unless the terms on which the floating charge was granted prohibited the company from granting any later charge having priority over the floating charge and the person in whose favour such later charge was granted had actual notice of that prohibition at the time when the charge was granted to him. See J O Orojo *Company Law and Practice in Nigeria*, (5th edn, LexisNexis Butterworths, Durban, 2008) 176-7.

[381] D Sasegbon, *Nigerian Companies and Allied Matters Law and Practice* (1st edn. DSc Publications, Lagos, 1991) 285.

should be on the fixed chargee. This argument however flies in the face of the express provision of section 179 of CAMA which requires "actual notice" of the term in the earlier floating charge prohibiting the grant of any later charge having priority over the floating charge.[382]

Also, the argument fails to take into consideration that mere notice of the existence of a previous charge is immaterial but actual notice of the restrictive clause in the earlier floating charge.

The rationale for allowing a subsequent fixed charge to generally have priority over an earlier floating charge appears to be because of the nature of the floating charge[383] by which the company can deal with the charged property in the ordinary course of business and *ipso facto* can create a later fixed or equitable charge over the prior floating charge.[384] It has also been submitted that the holder of a fixed charge

> deserves its priority position in its debtor's insolvency because the charge (a) helps control financial agency costs, or (b) encourages the chargee to provide new funding to troubled companies which, in the absence of the priority of fixed security, would not have been provided, or (c) both. This is mutually beneficial for all the parties interested in the debtor's undertaking since it lowers the risk of its ending up in insolvent liquidation and thus raises the expected value of the claims of all of its creditors, secured and unsecured.[385]

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[382] In *Chukwuogor v. Chukwuogor* (2006) 7 NWLR (Pt. 979) 302 at 316, Omokiri, JCA. held: "One of the cardinal principles of interpretation is to give the words of a statute, when clear and unambiguous, their grammatical and ordinary meaning. See *Egbe v. Alhaji* (1990) 1 NWLR (Pt. 128) 546; *Ahmadu v. Gov., Kogi State* (2002) 3 NWLR (Pt. 755) 502 and *Fawehinmi v. IG of Police* (2002) 7 NWLR (Pt. 767) 606.

[383] See *Government Stock and Other Securities Investment Co v. Manila Rly Co* [1897] AC 81 (House of Lords); *Illingworth v. Houldsworth* [1904] AC 355 (House of Lords); *Re Bond Worth Ltd* [1980] Ch.D 228,[1979] 3 All ER 919 Ch.D.

[384] J O Orojo, Company Law and Practice (n 380) 177. See D French, S Mayson and C Ryan, *Mayson, French & Ryan on Company Law* (24th edn Oxford University Press, Oxford, 2007) 300; R M Goode, Commercial Law (n 190) 686; *Wheatley v. Silkstone and Haigh Moor Coal Co* (1885) 29 Ch.D 715. *Re Castell and Brown Ltd* [1898] 1 Ch.D 315.

[385] R J Mokal 'The Floating Charge – An Elegy', in S Worthington (ed), *Commercial Law and Commercial Practice* (Oxford, Hart, 2003), 479.

The provision of section 179 of CAMA codifies the device forbidding the creation of any mortgage or charge ranking in priority to or *pari pasu* with the floating charge employed by holders of floating charges to improve their position vis a vis the holder of a fixed charge.[386] However, the utility of the restrictive/negative pledge clause[387] in the floating charge depends on whether it can be established that the grantee of the subsequent fixed charge has actual as opposed to constructive notice.[388] Mere insertion of the restrictive/negative pledge clause in the instrument creating the charge and registering same with the Corporate Affairs Commission will not suffice to displace the priority of the subsequent fixed charge because registration of an instrument of charge constitutes notice of only the charge and not notice of the contents of the charge except the particulars in the register of charges as stipulated in sections 197(a) and 198(1) of CAMA.[389] These particulars do not include particulars of prohibitions, conditions or restrictions including any negative pledge clause in the charge.[390]

In view of the widespread use of restrictive clause in floating charges, Farrar suggests that a subsequent fixed chargee who has notice of the earlier floating charge should be said to have

386 K Ajayi (n 376) 483. The contractual device which was referred to as a "restrictive clause" by Farrah was said to have been originally introduced as a suggestion in the first edition of Palmer's Company Precedents in 1877; J H Farrar, 'Floating Charges And Priorities' (1926) 38 Conv 315, 318.

387 A restrictive or negative pledge clause is a provision which prohibits the creation of subsequent fixed charges ranking prior to, or *pari passu* with, the earlier floating charge- G McCormack *Secured Credit under English and American Law* (Cambridge University Press, Cambridge, 2004) 102.

388 *English & Scottish Mercantile Investment Co Ltd v. Burton* [1892] 2 QB 700. According to Goode, the effect of notice is to subject the subsequent purchaser or encumbrancer to a personal equity in favour of the floating charge, so that the latter has priority even though his security interest has not yet attached; R M Goode , *Commercial Law* (n 190) 687.

389 Section 68 Cap C20 LFN 2010. I O Smith, *Sidelining Orthodoxy in Quest for Reality….* (n 389) 317. *English & Scottish Mercantile Investment Co Ltd v. Burton [1892] 2 QB 700*; *Re Standard Rotary Machine Co* (1906) 95 LT 829; *Wilson v. Kelland* [1910] 2 Ch.D 306; *Siebe Gorman & Co Ltd v. Barclays Bank Ltd* [1979] 2 Lloyd's Rep 142; R M Goode, *Commercial Law* (n 190) 664. *G & T Earle Ltd v. Hemsworth Rural District Council* (1928) 44 TLR 605.

390 I O Smith, *Nigerian Law of Secured Credit* (n 1) 317.

actual inferred knowledge so as to postpone the priority of the subsequent charge.[391] According to him:

> "… although a company which has created a floating charge containing a restrictive clause may create a subsequent mortgage or charge in favour of a person who has no proven actual knowledge such person may now in the light of registration, modern drafting and conveyancing practice and his right to inspect copies of the instruments at the Company's registered office be fixed with actual notice in the case of land and in any event with inferred knowledge of the existence of such a clause. He will therefore, not be able to claim priority".[392]

Farrar noted however that inferred knowledge is not the same as constructive notice of the clause in the company law sense.

Admirable as Farrar's position may seem,[393] the express requirement of section 179 of CAMA is "actual notice" of the restrictive clause and it is trite that statutes should ordinarily be given their literal meaning.[394] Furthermore, Goode has pointed out that there are "compelling reasons" in support of the traditional view. One, the traditional view is the approach taken in all cases even after the restrictive clause has become quite common and it is difficult to accept that the court did not have in mind inferred knowledge as well as constructive notice in the narrow sense. Two, the mere fact that a particular contractual provision is in common use has never been regarded as sufficient in commercial law to put a party on notice of its existence in relation to an individual transaction. Three, a person does

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[391] J H Farrar (n 386) 315.
[392] ibid 315, 329.
[393] R M Goode, *Commercial Law* (n 190) 64 described Farrar's argument as "an attractive one".
[394] *Ejuetami v. Olaiya* [2001] 18 NWLR (Pt. 746) 572 at 593; *N.P.A v. Lotus Plastics Ltd.* [2006] All FWLR (Pt. 297) 1023, *Obasanjo v. Yusuf* [2004] 9NWLR (Pt. 877) 144 at 182; *Attorney General of Bendel State v. Attorney General of the Federation* [1982] 3 NCLR 1.

not, at common law, have inferred knowledge of facts merely because a reasonable man would have been put on inquiry as it must be shown that he deliberately turned a blind eye.[395]

Beale and others have also suggested that it is neither necessary nor practical to use the doctrine of inferred knowledge in this situation.[396] It is thus the law that actual notice of the restrictive clause must be shown but the onus is on the third party to prove that he did not have actual notice.[397] It is, however, a matter of evidence whether such subsequent grantee of the fixed charge has actual notice. The evidence may be by way of showing that the holder of the later fixed charge conducted a search of the instrument of charge pursuant to section 192 of CAMA or by calling oral evidence to show that the holder of the later fixed charge perused or was given a copy of the charge to peruse.[398]

The question of proof of actual notice must not be taken lightly in view of the fact that mere possession of the charge instrument is not enough to confer notice of its contents.[399] It has been suggested that in practice, a bank which is thinking about making a secured loan to a corporate borrower will consult the register of charges and through this process details of previous secured borrowings by the company should emerge. Therefore, if details of a

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395 R M Goode, *Commercial Law* (n 190) 64. See *Re Castell and Brown Ltd* [1898] 1 Ch.D 315 where it was held that the subsequent charge bank was not bound to make any special enquiry.

396 According to Beale et al:
"The limits of constructive notice have been recently confirmed, and there was no mention of inferred knowledge in any of these cases. While the present position could not be said to be particularly certain, it is preferable to a doctrine which is applicable on the facts of each case. Further, since inferred knowledge is based on wilful shutting of eyes to the obvious, this situation is covered by placing of the onus of proof of lack of actual notice on the third party. Most lenders actually do search the register before lending, and therefore will have actual notice of the charge and any particulars actually registered: they will normally then protect themselves by coming to an agreement with the floating chargee" H Beale et al (n 240) 416.

397 H Beale et al (n 240) 416; *Re Salthill Properties Limited* [2004] IEHC 145; *GL Baker Ltd v. Medway Building and Supplies Ltd* [1958] 1 WLR 1216.

398 K Ajayi (n 376) 487; I O Smith, *Nigerian Law of Secured Credit* (n 1) 317.

399 K Ajayi (n 376) 487. See *Re Castell and Brown Ltd* [1898] 1 Ch.D 315; and *Re Valletort Sanitary Steam Laundry Co Ltd* [1903] 2 Ch.D

restrictive clause appear on the register then the subsequent secured lender will actually learn of their existence on consulting the register.[400] The strength of this suggestion still lies on availability of evidence of actual notice of the restrictive clause.

Goode's[401] suggestion that the restrictive clause may be included in the resolution creating the charge and be passed by special or extraordinary resolution which may be filed pursuant to section 237 of CAMA will not satisfy the requirement of actual notice by subsequent chargee.[402]

4.18 Priority between Two or More Floating Charges

Where a company has given a floating charge over its assets to a party and subsequently gave another party a floating charge over the same asset, it is the floating charge that was first created that will have priority,[403] However, where the subsequently created floating charge is over part of the asset over which the first floating charge was created, the subsequently created floating charge will have priority provided the first charge expressly empowered the company to do so.[404] Where there is no such express authorisation in the first charge, the prevalent view is that the first charge, being first in time should have priority.[405]

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400 G McCormack (n 387) 103.
401 R M Goode, *Legal Problem of Credit and Security* (2nd ed. Sweet & Maxwell, London, 1988) 44.
402 I O Smith, *Nigerian Law of Secured Credit* (n 1) 317.
403 *Re Benjamin Cape & Sons Ltd* [1914] 1 Ch.D 800. R M Goode, *Commercial Law* (n 190) 686. The equities being equal, the first in time prevails. L S Sealy, *Cases and Materials in Company Law* (7th edn, Oxford University Press, Oxford, 2004) 420.
404 *Re Automatic Bottle Makers Ltd* [1926] Ch.D 412.
405 L S Sealy (n 403) 420.

4.19 Crystallisation of Floating Charge and Priority

Crystallisation is the attachment of specific assets of the company hitherto constituting a floating charge upon the happening of certain event recognised or prescribed by law.[406] The effect of crystallisation is to convert the floating charge into a fixed charge[407] and this has priority implication because the charge will then have priority over any subsequent equitable charge and other unsecured creditors.[408]

Section 178(1) of CAMA provides for the events that make a floating charge to crystallise. According to Smith, the section 178(1) has restricted the events of crystallisation to the events stipulated in the section and thereby making other events of crystallisation at common law inapplicable. It was further submitted that the provision has rendered inoperative the concept of automatic crystallisation upon the occurrence of a particular event of default prescribed by the charge instrument, or semi-automatic crystallisation in the sense of a mere requirement of notice being given to the chargor by the chargee to terminate the company's licence to carry on business; nor does the breach of the term *per se* permit crystallisation".[409] It is therefore

[406] I O Smith, *Nigerian Law of Secured Credit* (n 1) 321.
[407] Section 178(2) of CAMA.
[408] *Mandillas and Karaberis Ltd v. Anglo-Canadian Cement Co Ltd* (1967) NCLR 42; (1967) (1) ALR Comm 42.
[409] I O Smith, Nigerian Law of Secured Credit (n 1) 322. See also K Ajayi (n 376) 491 who also took the same position as Smith. According to Ajayi "Section 178 (1) Companies & Allied Matters Decree 1990 enumerates and limits instances of crystallization to receivership brought about by order of court, or the chargee; liquidation; or entry into possession – thereby abolishing or making inapplicable, both automatic crystallization and crystallization by notice. Indeed, other common law means to crystallization (like cessation of business or sale of substantial assets other than in the ordinary course of business) are not applicable in Nigeria, in spite of spirited attempts to argue otherwise. Clearly, from the wording of the statute, the fact of breach of terms of the charge, or the occurrence of an event of default per se, which may make the security enforceable, does not permit crystallization – as such event must be coupled with the further step of taking possession, or the appointment of a receiver/manager by the charge."

submitted that the problem of priority attendant upon automatic crystallisation does not arise under the Nigerian Law.[410]

4.20 Efficacy of Floating Charge as a Priority Device

In view of the doctrinal position as to the priority of floating charge, Mokal submits that not only is the floating charge generally ineffective in giving its holder priority over others, it is in fact not a priority-based device at all.[411] According to the commentator, the floating charge "is a *residual management displacement device* which can work optimally *only* when it is part of a package of security interests covering the whole or substantially the whole of the debtor's property, and generally, only when this package includes fixed security over assets strategically important to the debtor's business". The writer further submits that this priority-independent view of the floating charge enabled an explanation of the peculiarities of the actual operation of floating charge and to understand why it was generally taken in combination with fixed charges, and either over the debtor's entire undertaking or over those assets not amenable to the draconian control of the fixed charge, and also to bring out the non-anomalous status of the 'lightweight' floating charge. The writer concludes that the analysis also helped throw light on the role of registration, and on the problems occurring at the boundary between the two types of charge.[412]

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[410] See K Ajayi (n 376) 488-90 who submits that the problem of priority between floating charges which automatically crystallise and fixed charges created subsequent to crystallisation and the issue of the propriety of automatic crystallisation are yet to be resolved under English Law. L Gullifer (n 195) 163 also expresses the view that even under English Law, there has been growing awareness in recent years of the disadvantages of automatic crystallisation and that in so far as automatic crystallisation clauses are used at all, their scope tends to be more narrowly confined.

[411] R J Mokal (n 385).

[412] ibid.

It may be said that while it is true that floating charge is not efficacious as a priority device in Nigeria as in England, the effectiveness of the floating charge as a residual management device in Nigeria will be a matter of debate, particularly in view of the hostile reaction and opposition by debtors to the appointment of receivers by secured creditors pursuant to the provision in all-asset debentures creating floating charges. It is also a common practice for debtors to apply for and obtain court injunctions to restrain or block the appointment of receivers.

4.21 Variation of Priority by Agreement

It is possible for parties to, by agreement, determine what would be their priority position under the priority rules[413] and this is a reflection of the freedom of contract in the field of secured credit.[414] According to Goode, there is nothing in either the common law or the statutory priority rules precluding secured creditors from making an agreement to vary the priority that would otherwise apply and that most of the statutory registration rules make express provision for this.[415]

Variation of otherwise applicable rules of priority may be done by way of waiver or subordination/priority agreement.[416] Beale *et al*, made a distinction between subordination agreement and priority agreement by pointing out that the former arises between unsecured creditors and the latter between secured creditors.[417] Goode, however, treated both an

[413] L Gullifer (n 195) 180.
[414] H Beale et al (n 240) 494.
[415] L Gullifer (n 195) 180.
[416] ibid,180.
[417] H Beale et al (n 240) 494.

agreement between secured creditors and an agreement between unsecured creditors as subordination agreement.[418]

It is submitted that it is more apt to refer to agreement varying priority between secured creditors as priority agreement while the agreement between unsecured creditors is subordination agreement strictly so-called.[419] However, the term priority agreement and subordination agreement will be used here in a loose sense and interchangeably.

4.22 Waiver of Priority of Security Interest

A holder of a security interest may agree to waive it in favour of a third party. The distinction between a waiver and contractual subordination is that waiver is voluntary and it may also deal with matters other than subordination as for instance there may be waiver of a negative pledge clause in a floating charge.[420] Waiver may be formal or informal and may be no more than exchange of letters. A pertinent issue is when will waiver be enforceable by a party asserting same?

In *Temco Engineering Co. Ltd v. Savannah Bank of Nigeria Ltd*,[421] it was held that in many respects the doctrines of waiver and estoppel cross paths, and on occasions the two terms have been used interchangeably or concurrently.[422] It has therefore been suggested that even though the question appears not to have been decided in this context, the general principle of promissory or equitable estoppels will operate to preclude the secured creditors giving the

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418 L Gullifer (n 195) 59, 180 and 191, 208.
419 See P R Wood (n 196), where subordination is defined as "a transaction whereby one creditor (the subordinated or junior creditor) agrees not to be paid by a borrower or other debtor until another creditor of the common debtor (the senior creditor) has been paid."
420 L Gullifer (n 195) 206.
421 [1995] 5 NWLR (Pt. 397) 607 at 620.
422 Reliance was placed on the English case of *Charles Rickards Ltd v.Openheim* [1950] 1 KB 616.

waiver from asserting his security interest or restrictive clause against the party who has altered his position by reliance upon the waiver so as to render it inequitable for the first creditor to resile from the promise.[423]

It is important for the application of promissory estoppels that the party in whose favour the waiver was given must have altered his position following the waiver, by for example advancing money to the debtor such that it would be inequitable to revert back to the position before the waiver was given as was held in *Umagaba v. Ogbe.*[424] Sagay[425] has criticised the decision in *Umagaba v. Ogbe.* In his view, once the promisee had acted on the promise, evincing a reliance on it, then he has altered his position and that detriment is not a relevant element in promissory or equitable estoppels. Therefore, the promisee does not have to establish that he acted on the promise or altered his position (which are both the same thing) to his detriment.[426]

It is submitted that the position of Sagay cannot be sustained in the light of the existing law on promissory or equitable estoppel. In *Temco Engineering Co. Ltd v. Savannah Bank of Nigeria Ltd*,[427] Uwaifo JCA, after a review of authorities, held that the requirement of prejudice or detriment is or remains part of the substantive law in matters of promissory, equitable or proprietary estoppel.[428] Therefore, a secured creditor that is seeking to enforce a

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[423] L Gullifer (n 195) 206. On promissory estoppels, see G Samuel (n 264) 193-199.
[424] [1996] 9 NWLR (Pt. 472) 377 at 382.
[425] I E Sagay *Nigerian Law of Contract* (2nd edn, Spectrum, Ibadan, 2003) 106.
[426] ibid.
[427] [1995] 5 NWLR (Pt. 397) 607.
[428] supra at 624.

waiver must show that he has relied on the promise of waiver and that he has altered his position by, for example, advancing money to the debtor in reliance on the waiver.

4.23 Priority/Subordination Agreement

As earlier stated, it is open to holders of successive security interests to vary the priority of their interests *inter se*. They may do this without the consent of the debtor as the debtor has no right to insist on the order in which the successive mortgage debts are satisfied.[429] A priority agreement does not result in an exchange of the security interest which could affect the ranking of the subordinated interest in relation to an intermediate security interest in favour of a third party.[430] It has however been suggested that:

> "If both the senior and the junior debt are secured, both the junior debt as well as the junior security should be expressly subordinated since, if the security is insufficient, both claims would be unsecured and would rank equally on the bankruptcy of the debtor unless the junior creditor had agreed to subordinate the junior debt as well as the junior security. Further, the security for the senior debt may turn out to be invalid, e.g because it is an insolvency preference. The security is often held by a security trustee for both senior and junior debt".[431]

There is difference between contractual subordination and waiver because while contractual subordination is given for consideration, waiver is voluntary.[432] Subordination agreement, like a waiver, is said to constitute an equity binding the party giving it and an assignee from him who is a volunteer or takes with notice of the subordination but not affecting a bona fide

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[429] *Cheah v. Equiticorp Finance Group Ltd* [1992] AC 472, [1991] 4 All ER 989. According to Lord Browne-Wilkinson: "The mortgagor is bound to satisfy all his secured debts before he can recover the mortgaged property. In the ordinary case priority of mortgages affects only the rights of the mortgagees inter se, in particular where the security is inadequate to pay all the secured debts in full"- [1991] 4 All ER 989, 991. See, Beale et al (n 240) 495-6 for an analysis of *Cheah v. Equiticorp Finance Group Ltd.*

[430] L Gullifer (n 195) 59.

[431] P RWood, (n 196) para 10-031.

[432] L Gullifer (n 195) 60.

purchaser for value (whether acquiring a legal or an equitable interest) without notice of the subordination.[433]

An issue that has been raised in connection with subordination agreement is whether the agreement is likely to be held in bankruptcy or winding up as contravening the *pari passu* rule. Gullifer submitted that none of the forms of contractual subordination commonly used contravene the *pari passu* principle[434] and that the judicial confirmation of the validity of subordination agreements in *SSL Realisations* "is very much to be welcomed."[435]

It is expected that when the opportunity presents itself, the Nigerian courts will also uphold the validity of subordination agreements.

4.24 Priority/Subordination Agreement: The Circularity Problem

There may be circularity problem in certain circumstances as regards priority of floating charge and fixed charge which circularity problem also implicates the preferential creditors who, in terms of priorities, are in between the fixed and floating charges.

A circularity problem may arise where the priority of a fixed-charge holder is postponed to that of a prior floating charge because the fixed-charge holder has actual notice of a restrictive clause. Second is where a fixed chargee agrees with a floating chargee to subordinate its interest to that of the floating chargee.[436] This has provoked judicial disagreement in

[433] ibid 208.
[434] ibid 210.
[435] *Squires & Ors v. AIG Europe (UK) Ltd & Anor* [2006] EWCA Civ 7 (18 January 2006); available at: http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWCA/Civ/2006/7.html&query=title+(+Squires+)+and+title+(+v+)+and+title+(+AIG+)&method=boolean ; last visited on 6th December, 2015.
[436] L Gullifer (n 195), 211.

England.[437] One view is that by coming after the floating charge, the fixed charge should therefore come after the preferential creditors. Thus, in *Re Portbase Clothing Ltd*,[438] it was held that by subordinating its claims to those of the floating charge, the fixed charge is also subordinated to that of preferential debts.[439] Even though the result in the case was stated to be dictated by the statutory policy of protecting preferential creditors, Gullifer rightly disagrees with this view. According to Gullifer:

> "The purpose of the legislation is to give preferential debts priority over those secured by a floating charge, not over debts secured by a fixed charge. The result is that the preferential creditor gain a windfall from an agreement to which they were not a party, which was not intended to benefit them and which can do so only at the expense of the fixed charge".[440]

Therefore, a possible solution is said to be to apply the doctrine of subrogation and to hold that, by virtue of the altered priorities between them, the floating-charge holder stands in the shoes of the fixed-charge holder to the extent of the amount secured by the fixed charge and therefore the floating-charge holder will be paid ahead of preferential creditors by the degree to which liabilities are secured by a fixed charge.[441] Further, and in disagreeing with the position of Chadwick J that there ought not to be recourse to subrogation, Goode submits that applying the principle of subrogation avails the floating chargee with the opportunity to enforce the chargee's priority directly and for its own benefit as this will achieve the result intended by the subordination agreement but without disturbing the position of the

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[437] Contrast *Re Woodroffe's (Musical Instruments) Ltd* [1986] Ch.D 366 with *Re Portbase Clothing Ltd* [1993] Ch.D 388.
[438] [1993] Ch 388.
[439] See H Beale et al (n 240) 496-501 for an analysis of the decision of Chadwick J in *Re Portbase Clothing Ltd* [1993] Ch.D 388.
[440] L Gullifer (n 195) 212.
[441] G McCormack (n 387) 103. See also Gullifer L. (n 195) 212 and *Re Woodroffe's (Musical Instruments) Ltd* [1986] Ch.D 366, 368.

preferential creditors, who are neither prejudiced nor enriched by a purely inter-creditor agreement.[442]

4.25 Marshalling of Securities

Marshalling of securities is an equitable doctrine that may be described as the process by which equity intervenes to protect the secured status or priority-ranking of a creditor holding *mesne* or junior-ranking security following the enforcement of a prior-ranking security.[443] The doctrine is aptly described by Alli thus:

> The doctrine typically applies where one creditor (the "senior creditor") holds first ranking security over two or more assets of a debtor as security for the repayment of a common debt, and another creditor (the "junior creditor") holds a second ranking security over one of those assets. Should the senior creditor recoup its secured debt by enforcing its security against that asset, which is also subject to the junior creditor's security, the doctrine of marshalling will permit the junior creditor to 'marshall' the senior creditor's security. By this it is meant that the junior creditor will, via the intervention of equity, be placed in the position of the senior creditor, as against those assets of the debtor which are subject to only the senior creditor's security, to the extent of any deficiency in the junior creditor's security.[444]

Therefore, the doctrine in effect operates to preserve the junior creditor's priority-ranking qua the debtor.[445] It has however been pointed out that marshalling is not really about determining whether or not the claim of one creditor deserves precedence over that of another. Rather, that marshalling "acts to preserve the existing priority of *puisne* secured creditors, by conferring upon such creditors the benefit of a security held by a prior-ranking creditor".[446]

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[442] L Gullifer (n 195) 213.
[443] P A U Alli *Marshalling of Securities: Equity and the Priority-Ranking of Secured Debt* (Oxford University Press, Oxford, 1999) 3.
[444] ibid 3.
[445] ibid 3.
[446] ibid 4.

4.26 Appraisement of Priority of Security Interest under Nigerian Law

An essential requirement for viable legal regime is certainty of the security right and this includes that the lenders should have certainty as to his priority against other persons with rights in the secured assets.[447] No doubt, the fact that there are rules for regulating priority affords the opportunity of creation or existence of multiple security interests over an asset, the points for critical comments are the certainty, adequacy and simplicity of these rules of priority.

It has been commented by Gravells that:

> "The law relating to priorities appears to be complicated; but this is largely because the factual situations include so many variable factors: whether the mortgages relate to a legal estate or an equitable interest; whether the mortgages relate to registered or unregistered land; whether or not the first mortgage is protected by a deposit of title deeds; whether the first mortgage is a legal or equitable mortgage…".[448]

Although the view of Gravells is that if these variable factors are considered systematically, the position can be stated with reasonable clarity, it is submitted that the fact that the determination of priorities will depend on so many variables makes the law unwieldy and may make the position of the parties uncertain as to their priority position, at least *ex ante*. Further, what is manifest from the expository analysis of rules of priority under the Nigerian law in this study is that the Nigerian law of priority just like the English law of priority to which it owes its origin is not free from complexity.

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[447] J L Simpson and J M Rover, 'General Principles of a Modern Secured Transactions Law Rights' in J J Norton and M Andenas (eds), *Emerging Financial Markets and Secured Transactions* (Kluwer Law International, London 1998) 143, 147.

[448] N P Gravells (n 216) 812.

In the first instance, the general rule that priority is to be determined by the temporal order of creation of security interests has been totally emasculated not only by the numerous exceptions but by statutory provisions regulating priority by the date of registration. The practical effect is that there is really no general benchmark or veritable default rule for regulating priority of security interests as applicable under Article 9 of the US Uniform Commercial Code and Personal Property Security legislation jurisdictions.[449]

Even where the general rule of temporal order of creation would have been applicable same may be displaced by the conduct of the parties in terms of knowledge of the pre-existing interests. The interpolation of the issue of conduct of parties in terms of knowledge of pre-existing interests created but not perfected may raise evidential issues and may well render the priority regime to be uncertain as well as susceptible to litigation. That the issue of knowledge of pre-existing interest may be dispensed with in the context of determination of priorities may be exemplified by Article 29 of the Convention on International Interest in Mobile Equipment on Matters Specific to Aircraft Equipment, 2001 where it is provided that a registered interest will still retain priority even if the registered interest was acquired or registered with actual knowledge of the other interest and even as regards value given by the holder of the registered interest with such knowledge.

The plea of bona fide purchaser for value of the legal estate without notice provides another core area of the law of priority under the Nigerian Law. Whereas there is a large-body of case-law of when a person may be said to be a bona fide purchaser, it is submitted that it may

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[449] Like Australia, New Zealand and Canada.

still be pretty difficult to predict with certainty in advance the outcome of a contest involving a plea of bona fide purchaser. It is further submitted that a reformed priority system based on notice-filing will eradicate the need for the plea and thus reduce the complexity characterizing the existing law.

Another major problem of the rules of priority of security interests under the Nigerian Law is the asymmetry between perfection and priority. Indeed, an area of perplexity of the law relating to priority under the Nigerian law has to do with asymmetric relationship between perfection of security interests and priority. Generally, perfection does not guarantee priority but it has been rightly submitted that "[I]t is in the priority stakes that perfection of a security interest acquires significance. Perfection does not guarantee priority, but an unperfected security interest will almost always be subordinated to or displaced by competing interests and by unsecured creditors in the debtor's bankruptcy or winding up."[450]

In the context of a Bill of Sale transaction, perfection is essential not only to perfection but is crucial to the enforcement of the security interest between the parties. Thus, in *Adetoyin v. Bank of the North Limited*,[451] the seizure of goods purportedly pursuant to what was characterised by the court as a Bill of Sale transaction which was not attested and registered was held invalid.

Further, perfection by way of registration of charges under CAMA although not determinative of priority, has some relevance in priority disputes. Firstly, registrable interests not registered

[450] L Gullifer (n 195) 174.
[451] [1976-1984] 3 NBLR 191.

are void against secured creditors and in this regard, the holder of an unregistered interest will lose priority to holder of a subsequent registered interest.[452] Secondly, registration may, in certain instances, count as constructive notice and therefore relevant to the operation of the priority of legal interest over an equitable interest or to the operation of the rule in *Dearle v. Hall*.[453]

The complexity brought about by the asymmetric relationship between perfection and priority has however been done away with under the Article 9 of the UCC[454] and Personal Property Security Act (PPSA) jurisdictions[455] where the filing of the financing statement, that is an act of public registration, is generally the default rule for determining priority of security interests.

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452 Section 197 Cap C20 LFN 2010.

453 K Ajayi (n 376) 483. See H Beale and others (n 240) 408 on similar provision of section 860 of the United Kingdom Companies Act, 2006.

454 Under the Uniform Commercial Code (UCC) which is applicable in the US, Article 9-322 of the UCC provides for general priority rules for determining priority among conflicting security interests. Generally, priority is to be determined according to priority in time of filing or perfection; Article 9-322(a)(1) of the UCC. The priority will date back to the earlier of the time a filing covering the collateral is first made or the security interest is first perfected so far as there is no period thereafter when there is neither filing nor perfection; Article 9-322(a)(1) of the UCC. A perfected security interest has priority over a conflicting unperfected security interest; Article 9-322(a)(2) of the UCC. Where the conflicting security interests are unperfected, priority will be given to the first security interest to attach or become effective; Article 9-322(a)(3) of the UCC.

455 Similar to the provision under the Article 9 of the UCC is the provision under Section 64 of the Personal Property Security Act of Victoria, British Columbia, Canada; Similar provision as Section 64 of PPSA British Columbia, Canada is contained in Section 64 of The Personal Property Security Act of Saskatchewan. The general or "residual" priority rule is that priority between perfected security interests in the same collateral is determined by the order of the occurrence of the following: the registration of a financing statement without regard to the date of attachment of the security interest; possession of the collateral in accordance with section 24 without regard to the date of attachment of the security interest; perfection under section 5,7,26,29 or 78 whichever is the earliest of these; Section 64(1)(a) of PPSA British Columbia, Canada. Just like under the UCC a perfected security interest has priority over an unperfected security interest (Section n 64(1)(b) of PPSA British Columbia, Canada) and priority among unperfected security interest is determined by the order of attachment of the security interest; Section 64(1)(c) of PPSA British Columbia, Canada. The 'first-to-file-or-perfect' lies at the heart of priority rules under the Article 9 and PPSA jurisdictions; G McCormack, (n 387) 80. The policy that dictated same has been explained thus: "Once a financing statement is registered any person who is planning to deal with someone named as debtor in the financing statement has the ability to determine whether or not the interest he intends to acquire will be subject to a security interest having a prior status. If such a person goes ahead and acquires an interest in the personal property described in the financing statement without making some accommodation with a registering party or without obtaining a discharge of the financing statement, there is no reason to give his interest priority over a subsequent security interest acquired by the registered party"; R Cunning and R Wood, 'Compatibility of Federal and Provincial Personal Property Security Law' (1986) C.B.R. 267 at 285.

Further, as is clear from the position of EBRD[456] and OAS[457] Model Laws,[458] it is possible to have two alternatives as regards creation, perfection and determination of priorities. Under the EBRD Model, valid creation of security interests is made a point of priority for multiple security interests created over an asset in which case, however, act of public registration, is an integral part of the requirements of creation of the security interest. The benefit of this alternative is that it will obviate the issue of dichotomy between creation and perfection of security interests and ensure priority upon valid creation of the security interests. The OAS alternative, however, recognises the dichotomy between creation and perfection of security interests but fulfilment of the publicity requirements is essential to the effectiveness of the security interest against third party as well as priority. The benefit of this alternative is to make perfection a general priority point. The OAS alternative is in line with the position under Article 9 model and PPSA legislations.

456 1994 EBRD Model Law on Secured Transactions which was prepared by the European Bank for Reconstruction and Development. See R Goode, H Kronke, E McKendrick and J Wool *Transnational Commercial Law: International Instruments and Commentary* (Oxford University Press, Oxford, 2004) 454 for the text of the EBRD Model Law. Article 17.1 of the EBRD Model Law provides that a charger may grant more than one charge over the same right or thing and by Article 17.2, the general rule for priority between different charges over the same charged property under the EBRD is determined in accordance with the time at which they were created or deemed to be created except as otherwise provided in Article 17. Thus, generally, whether or not a charge can be said to have been created is crucial in determining priority of charges under the EBRD Model Law hence making pertinent the question of when a charge is created under the EBRD Model law.

457 2002 Model Inter-American Law on Secured Transactions, OAS Model Law. See R Goode, H. Kronke, E McKendrick and J Wool (n 456) 481 for the text of the OAS Model Law. The OAS Model Law distinguishes between the requirements for creation of an interest and those for its perfection. All that is required for creation of a security interest is an agreement, which in the case of a non-possessory security interest must be in writing and contain various items of information, including the maximum amount secured. To be effective against third parties, the security interest must be publicized, by registration or by delivery of possession or control to the creditor of a third person on its behalf. Under the OAS, fulfillment of the publicity requirements is essential to the effectiveness of the security interest against third party as well as for priority purposes. It is provided that the right conferred by a security interest in respect of the collateral is effective against third persons only when the publicity requirements have been fulfilled (Article 47 OAS.) and the priority of a secured interest is determined by the time of its publicity; Article 48 OAS. This Article also provides that a security interest confers on the secured creditor the right to follow the collateral in order to exercise its rights under the security.

458 A model law is not a legally operative instrument and is not open to ratification but states may enact it in full or in part or reject it- R Goode, H Kronke, E McKendrick and J Wool (n 456) 435.

The position of the law as regards priority of security interests created by companies, particularly as it relates to floating charges is far from being satisfactory aside the issue of complexity and circularity problems that may arise.

The present writer agrees with the submission by Mokal [459] that floating charge is not efficacious as a priority device. However, while the submission that the floating charge is really a management displacement device may be true in practice in England such may not be the case in Nigeria where there are major impediments to appointment of receivers as a means of enforcement of the floating charge. It may also be said that the issue of characterization of charge which has brought much perplexity to the law of charges come about also as a result of the weak priority position of floating charge and desire by lenders to avoid characterization of their charges as floating charges with the attendant priority consequences.

The rule in *Dearle v. Hall* and the attendant problems, complexity and unsuitability to the requirement of modern financing is a further illustration of the problems of the rule of priority of security interests. Goode has rightly submitted that even though the rule works well enough when a single debt is assigned but that the rule is quite impracticable when applied to a continuous flow of dealings in receivables involving a substantial number of debtors[460] and that the rule unnecessarily impairs the efficacy of transactions such as invoice discounting and block-discounting. The commentator elsewhere submits that the rule is "wholly unsuited to modern receivable financing".[461]

459 R J Mokal (n 385).
460 R M Goode, *Commercial Law* (n 190) 642 - 643.
461 L Gullifer (n 195) 177.

While submitting that it is high time that the rule was abolished,[462] Goode further submits that if registration were to be extended to cover all assignments of pure intangibles, whether outright or by way of security, *Dearle v. Hall* would de facto become obsolete in view of the fact that the rule is effectively displaced where the previous security or assignment is registrable and is duly registered.[463]

In connection with problem of priority of security interest in chose in action, particularly in the context of receivable financing, Oditah has criticised what he called the 'poverty of *Dearle v. Hall*'. According to the commentator, even though the decision might have been justifiable in the context of its peculiar facts, "...the rule has remained unreformed, and has been extended by analogies inexact, if not false, to new areas for which it was hardly designed. The rule is now so antiquated that it belongs to the past generation. For many reasons it ought no longer to be applied outside trust-related priority disputes".[464] While agreeing with the foregoing positions of Goode and Oditah, it is further suggested that a system of public notice filing/registration of all security transactions be put in place to replace the rule and that the temporal order of notice filing/registration should govern priority.

The discussion in this chapter on tacking of further advances also brings to fore the complexity of the Nigerian law on priority of existing security interests in respect of further

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462 R M Goode, *Commercial Law* (n 190) 642 - 643. It was further submitted by Goode that if registration were to be extended to cover all assignments of pure intangibles, whether outright or by way of security, *Dearle v Hall* would de facto become obsolete. This is in view of the fact that the rule is effectively displaced where the previous security or assignment is registrable and is duly registered.

463 ibid

464 F Oditah (n 322) 140. The reasons adduced by the commentator are: *Dearle v. Hall* is not rooted in coherent principles; the refinements on the rule take it close to pure fiction; *Dearle v. Hall* notice may be uninformative because it need not specify that the debt ought to be paid to the assignee; *Dearle v. Hall* does not require written notice; *Dearle v. Hall* is illogical; *Dearle v. Hall* is harsh and absurd when applied to expectancies; *Dearle v. Hall* is a counsel of perfection where there is an assignment of streams of receivables due from a multitude of debtors-ibid 141-143.

advances. This is in contrast with the position under Article 9 and PPSA where the position appears to be simpler. One is thus agreeable with McCormack's submission that: "If there is one small benefit that the changeover to an Article 9 model might provide it is to do away with the complicated 'tacking' rules. Under Article 9, priorities between different security interests are generally resolved on the basis of a simple first-to-file-prevails principle, and priority extends to subsequent advances made by the secured party having priority".[465]

The issue of recognition and applicability of Purchase Money Security Interests (PSMI) under the Nigerian law is also an area of critical concern. It is submitted that the absence of any judicial pronouncement on PSMI in Nigeria may be said to be part of the underdeveloped nature of our secured credit law and practice. As it were, it is safe to assume that the Nigerian courts will likely follow the English decisions on PSMI when an opportunity comes up and as such the correct criticisms of English law on this point will also be valid here. It will thus be necessary to consider having legislation along the line of Article 9 or the PPSA on the issue of PSMI. This, perhaps, may even encourage lenders in Nigeria to make loans available on the strength of PSMI.

As part of the exercise of the right to freedom of contract, parties to security transaction may enter into priority and/or subordination agreements but like any other contract, the terms of the priority and/or subordination agreements are binding only on the parties and the fact that priority agreement may lead to circularity problem with the controversy attendant thereto.

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[465] G McCormack (n 387) 101.

What is obvious from the circularity problem is that lack of a uniformed and functional concept of security with the consequential formalism of security interests which have different legal consequences as regards the nature of the interests contribute also to the problem of complexity of the rules as to priority of security interests. Thus, the nature of the interest held by the parties to priority agreements may impact on such parties negatively as regards realisation of their security interests, particularly where the agreement is between a fixed chargee and a floating chargee and the debtor has become insolvent. Thus while negotiated contractual solutions are often resorted to in view of the problem of complexity, obscurity and confusion of the rules of priority of security interests,[466] it is submitted that nothing short of a reformed and simplified rules of priority would be adequate in the circumstance.

4.27 Summary

This chapter has undertaken an expository and critical appraisal of priority of security interests under the Nigerian law and in the process the position of the law in England from where Nigeria received its law was examined alongside the Nigerian law for completeness. In addition, and for comparative reason, the position of the law under Article 9 as well as Personal Property Security legislations jurisdiction and the position on international plane under the EBRD and OAS Model laws and Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft as regards priority were also examined.

[466] ibid 101.

The study finds that issue of priority and its determination arises because of possible conflicting claims by two or more persons in relation to a property due to the fact that the law recognises that multiple interests can exist in respect of an asset. It was found that the issue of priority is not only crucial to the value of security but may, in fact, determine the accessibility of credit advances to debtors. In view of the fact that credit advances is crucial to economic development of a society, it was submitted that the importance of rational, simple and coherent rules of priority of security interests cannot be overemphasised.

The study examines nature and types of priority disputes and the views of commentators like Goode, Sykes and Walkers, and Keinan in this regard. The study finds that apart from the problem of determining priority between secured creditors some other problems have to do with determination of the priority between secured and unsecured creditors, and between secured creditors and good-faith purchasers. Even though the primary focus of the study is on competing claims between rival claimants where two or more security interests have been created over the same secured property, the position of an outright buyer of a property in a competing claim against a secured creditor in respect of the same property also becomes relevant.

Debates as to whether according priority position to the claims of secured creditors is justifiable were also examined. The views of various commentators like Vinch, Mokal and Goode were examined. There is a view that priority of secured creditor is not justifiable because it violates the basic principle of rateable distribution of the estates of an insolvent person and that same also derogates from the principle of consensual non-subordination.

There is another view that states that priority of security interests is justifiable on the ground of freedom of contract as well as value, and notice arguments. The relative strength and weaknesses of these contentions were examined. While, the study finds that none of the contentions either against or in support of priority position of security interests may singly stand without its own adverse criticisms, the study submits that the position of Vinch stems from the standpoint that security interests bypassed the *pari-passu* rule but this is not the case. The study submits that the priority position of holders of security interests is a necessary incidence of the operative property law rule by which proprietary right was vested in the secured asset in favour of the holder of the security interests. The study further submits that it will not be correct to state that the priority position of holders of security interests bypasses the *pari-passu* rule or constitutes an exception thereto because the *pari-passu* rule does not apply to secured creditors because the secured assets do not, legally speaking and as an incidence of the security right created, belong to the debtor to the extent of the security interests even though the debtor does have an equity of redemption. Therefore, the study submits, the proper inquiry, should be whether, as matter of policy, it is justified to continue to recognise the priority position of secured creditors and if the answer is in the affirmative what will be the consideration for such recognition and the boundary of the priority rights, particularly *vis a vis* unsecured creditors. In this regard, the study submits that recognition of security interests and, *a'fortiori*, the priority position of a secured party is justifiable on the ground that recognition of security interest promotes the growth of the economy.

In examining the rules on priority, the study examines the general rule of priority that priority is to be determined by the temporal order of priority. The study finds that the general rule yields to complexity because not only does the general rule admit of exceptions but the general rule is not universally applicable as the general rule may be displaced by facts and circumstances of the transaction, nature of the transaction and the competing legal interests involved, that is, whether legal interests or equitable interests. Also, the fact that conduct of the parties may, in certain circumstances, be relevant in determining priorities compounded the complexity of the rule as evidential issue may be raised aside the fact of susceptibility to litigation.

The plea of bona fide purchaser for value of the legal estate without notice as a means of gaining priority by a subsequent legal estate over a prior equitable interest was examined and the study finds that because the determination of whether a party is a bona fide purchaser depends on different factual variables, the continuous existence of the pleas may not augur well for certainty of the law on priority. It is submitted that a system of notice filing on security interests will be suitable in doing away with the plea.

The study examines the rules of tacking of further advances and *tabula in naufragio*. The study finds that the law on this is complex and fraught with many controversial areas rendering this area of law cumbersome, complex and uncertain. It is suggested that the provisions under Article 9 and PPSA regime is conducive to a simpler legal regime. It was also found that the position of the law on purchase money security interests is largely uncertain and unsatisfactory.

The asymmetric relationship between perfection and priority under the Nigerian law is also found to be not conducive to simplicity and certainty of the law. The study also examines, on a comparative basis, the position of the law on priority under Article 9 applicable in the US and under the Personal Property Security legislation applicable in Canada with a view to demonstrating the pattern that the needed reforms of Nigeria law should take. On the whole, the study finds that the present rules of priority of security interests under the Nigerian law is complex, cumbersome and is not conducive to emergence of asset securitization. Therefore, the study recommends reform of the law on priority of security interests.

Chapter Five

Asset Securitization and Challenges of Enforcement of Security Interests in Nigeria

5.1 Introduction

The success of asset securitization is largely dependent on making good the returns to the investors in the asset backed securities, which in turn may be dependent on prompt payment of the underlying receivables as well as prompt cost effective and adequate realization or enforcement of underlying security interests. Indeed, the adequacy of the law on security interests is determinable by the ability of the secured lender to realize the security and recover the underlying indebtedness in the event of failure to repay by the debtor. It has been commented that security "obviously becomes unattractive if it cannot be realized at the end of the day with minimum difficulty or headache".[467]

There appears to be prevalent recalcitrant attitude on the part of debtors/mortgagors to resist the enforcement of security even after benefitting from the loan agreement underlying the mortgage transaction. For instance, in *Akano v. F.B.N. Plc*,[468] the appellant resisted the attempt to gain possession by the respondent of a mortgaged property bought from the Respondent. The Respondent/mortgagee sold the property after the appellant, after repeated demands, refused to repay the debt in respect of which the mortgage was created. When the respondent could not gain possession, she brought an action heard in 1998 after which she was successful but the appellant appealed to the Court of Appeal which dismissed the appeal of the appellant in 2003 after about five years of litigation.

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[467] I A Umezulike, *ABC of Contemporary Land Law in Nigeria* (Snaap Press Nigeria Ltd, Enugu, 2013) 324.
[468] [2004] 8 NWLR (Pt.875) 318.

In this connection, it has been commented that the experience is that some obligees are overweening and excessive, while obligors could be duplicitous, and it is this that leads to premature or wrongful enforcement of security on the one hand, and the abuse of court process to stop the legitimate and contractual right to realize mortgaged assets on the other hand.[469] It is also observed that there are at times inconsistent positions by the court on certain issues surrounding secured transaction cases thereby creating uncertainty in law on certain aspects of enforcement of security interests.

The relevance of this chapter is that the whole essence of the right of priority and the right of pursuit inherent in the creation of security interest will be defeated or at best not realized where enforcement becomes difficult, if not totally impossible. This will negatively impact success of the asset securitization as the underlying asset backed securities would not be cash-backed to repay the investors.

This chapter therefore highlights, examines and discusses certain thematic issues on enforcement of security interests. The chapter will briefly set out the four kinds of security interests and then highlight those relevant to asset securitization. Thereafter, the chapter will examine some of the challenges of enforcement of security interests in Nigeria generally. The more recent legislative efforts at reforming the law of mortgage security which is the Lagos

[469] K Ajayi, O Adetunji and K Amewhule, 'Neither A Lender Nor A Borrower Be? A Consideration of the Problems Relating To Foreclosure, Injunction and Mortgages' in O Ajayi (ed) *Legal Aspects of Finance in Emerging Markets* (LexisNexis Butterworths, Durban, 2005) 511.

State Mortgage and Property Law, 2012[470] will also be considered. The chapter will conclude with summary and recommendations.

5.2 Kinds of Security Interests

There are four kinds of security interests under the Nigerian Law; mortgage, charges, lien and pledge.

5.2.1 Mortgage

A mortgage is a conveyance of title to property that is given as security for the payment of a debt or the performance according to the stipulated terms. It is also described as a legal or equitable conveyance of title as a security for the payment of debt or the discharge of some other obligation for which it is given, subject to the condition that the title shall be re-conveyed if the mortgage debt is liquidated.[471]

Mortgages may be legal or equitable. A legal mortgage arises when the owner of property surrenders his legal title of property to a lender or creditor to secure payment of the owner's debt. The legal title reverts to the original owner the moment the loan is repaid or debt is liquidated. A legal mortgage is the most secure and comprehensive form of security. It transfers legal title to the mortgagee and prevents the mortgagor from dealing with the mortgaged property while it is subject to the mortgage.

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470 Law No. 6 of 2012.

471 I O Smith, *Practical Approach to Law of Real Property in Nigeria* (Revised edn, Ecowatch Publications Nigeria Ltd, Lagos, 2013) 354. See D Franklin and S A Harms *International Commercial Secured Transactions* (Thomas Reuters Canada Ltd, Toronto, 2010) 80.

The modes of creation of the two kinds of mortgages are different. On the one hand, legal mortgage is created by Deed of Mortgage or Mortgage Deed.[472] On the other hand, equitable mortgage is one in which the lender is secured by taking possession of the original title documents of the property that serves as security for the mortgage. It may be effected by mere delivery of documents of title of property to the mortgagee. The mortgagor through memorandum of deposit, undertakes to grant a legal mortgage if he fails to pay the mortgage money.[473] It is no longer possible to create an equitable mortgage by mere deposit of title deed in Lagos State by the provisions of section 18 of the Lagos State Mortgage and Property Law 2012.[474] The deposit of title must be accompanied by an agreement to create a legal mortgage in favour of the mortgagee. The distinction between legal mortgage and equitable mortgage has legal implications in the context of enforcement of the security.

5.2.2 Charge

A charge is a hypothecatory form of security and is created by contractual act of the parties and exists, as well as being enforceable, only in equity.[475] However, in relation to land, at least under the Property and Conveyancing Law,[476] (PCL) a charge must be expressed to be by way of legal mortgage.

In *Re Charge Card Services Ltd*,[477] it was held:

> "Thus the essence of an equitable charge is that, without any conveyance or assignment to the chargee, specific property of the charger is expressly or constructively appropriated to or made answerable for payment of a debt, and the chargee is given the right to resort to the property

[472] *Gwarzo v. Mohammed* [2013] 12 NWLR (Pt. 1369) 576 at 605.
[473] supra at 605. See also: *First Bank of Nigeria Plc v. M. O. Nwadialu and Sons Ltd* [2015] 22 WRN 103.
[474] Law No. 6 of 2012.
[475] W J Gough, *Company Charges* (2nd edn, Butterworths, London, 1996) 18.
[476] Section 100 Cap 132 Laws of Osun State of Nigeria.
[477] [1987] Ch.D 150 at 176.

> for the purpose of having it realised and applied in or towards payment of the debt. The availability of equitable remedies has the effect of giving the chargee a proprietary interest by way of security in the property charged."

A charge has also been described as effectively an encumbrance over an asset and that it does not bestow possession nor does it transfer title to the charged asset but provides the lender with rights over the asset. Therefore, if the borrower defaults on the loan repayments, the lender has the right to try to recover the debt by realizing the secured asset.[478] A charge may be either a fixed charge, a floating charge or a combination of both fixed charge and floating charge.[479] The distinction between a fixed and floating charge[480] is significant in the event of a borrower's insolvency.

5.2.3 Pledge

A pledge may be described as a means of creating security by actual or constructive delivery of a tangible movable asset to a creditor to be held until the debtor performs an obligation. Pledge essentially transfers possession of an asset to the creditor and does not transfer ownership.[481] Thus, pledge is rooted in possession and it has been described as a bailment of goods, or delivery of documents of title to goods or negotiable instruments, to a creditor as security for any debt until it is discharged. There must be transfer of possession, in fact as well as the right to possession (including immediate possession).[482]

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[478] See D Franklin and S A Harms (n 471) 77.
[479] H Picarda, *The Law Relating to Receivers Managers and Administrators* (Tottel Publishing Ltd, West Sussex, 2006) 23.
[480] A fixed charge is a charge over specific property of a company which fastens on the property when the charge is created. A floating charge creates an immediate security over all company's assets or undertaking or a particular category of them but without attaching to any until crystallization: See I O Smith, *Nigerian Law of Secured Credit* (n 1) 297-303.
[481] D Franklin and S A Harms (n 471) 82.
[482] W J Gough (n 475) 21.

In *Adetona v. Zenith Bank Plc,* [483] the distinction between mortgage and pledge was highlighted. In that case, it was held that the main difference between a mortgage and a pledge is that in the former, the general title in the property is transferred to the mortgagee subject to be reversed by performance of the condition; whereas by the latter, the pledgor retains the general title and parts with the possession. Thus, by a mortgage the title is transferred; by a pledge, possession is transferred.

An essential characteristic of pledge is that for a pledge to take effect delivery is essential and thus a debt cannot be pledged.[484] This characteristic makes pledge to lack utility in asset securitization. Therefore, enforcement of pledge will not be considered in this study.

5.2.4 Lien

A lien, broadly speaking, is a right to retain that which is in one's possession belonging to another till certain demands of the person in possession is satisfied.[485] In other words, a lien may be described as "the right to retain an asset belonging to one person which is rightfully and continuously in the possession of another person until an obligation is performed or the present accrued claims of the person in possession have been satisfied".[486] According to Smith, a lien is a right to retain property until indebtedness is discharged. A lien differs from a mortgage in that it arises not necessarily from the agreement between the parties in creating

[483] [2011] 18 NWLR (Pt. 1279) 627 at 678; [2012] All FWLR (Pt. 611) 1443 at 1466.
[484] D Franklin and S A Harms (n 471) 82.
[485] *Afrotec Tech Services Nigeria Ltd v. MIA & Sons Ltd* [2000] 15 NWLR (Pt. 692) 730.
[486] D Franklin and S A Harms (n 471) 81.

the security but generally by operation of law.[487] Four main types of lien may arise, that is, common law lien, equitable lien, statutory lien and contractual lien.

In view of the requirement that the asset that is the subject matter of lien should be rightfully and continuously be in the possession of the lienee, it is inconceivable how security interests in the form of lien can be utilized in asset securitization. Therefore, of the four kinds of security interests, the relevant ones to asset securitization are mortgages and charges and the discussion on enforcement of security interests in this study will focus on enforcement of these.

5.3 Enforcement of Mortgage Security

Aside the claim for the recovery of debt, a mortgagee may enforce the security by entering into possession, selling the mortgaged property, appointing a receiver, and foreclosure of equity of redemption. The methods of enforcement are cumulative and not exclusive.[488] In *Olori Motors Co. Ltd v. U.B.N Plc*, it was held that it would be proper that a mortgagee that has become a judgment creditor, after being successful in an action for recovery of the debt may exercise power of sale based on the deed of mortgage.[489] Katsina-Alu, JSC, however, dissented when his Lordship stated:[490]

> "One more point. It has been said that the plaintiff resorted to its power of sale under the mortgage and sold two of the defendants' properties without going back to court. My short answer to that is simple. When the plaintiff elected to go to court, it waived its power of sale under the mortgage."

[487] I O Smith, *Nigerian Law of Secured Credit* (n 1) 37.
[488] ibid 73.
[489] [2006] 10 NWLR (Pt. 989) 586 SC per Pats-Acholonu, JSC at 611 para G-H.
[490] supra at 617 paras. D-E.

The present writer disagrees with the dissenting opinion of Katsina-Alu JSC. In *Salako v. Federal Loans Board*,[491] it was held that the mortgagee is entitled to pursue any or all of the remedies, subject to the power of sale, and appointing a receiver, and the restrictions imposed by agreement or by statute according as the powers are express and statutory.

The form of mortgage will determine the mode of enforcement. In the case of a legal mortgage, the security may be enforced by the appointment of a receiver, taking possession, sale and foreclosure.[492] One of the attractions of legal mortgage is the power of the mortgagee to enforce the security by sale outside court. However, in practice and as will be discussed hereafter, the exercise of this power is subject matter of protracted litigation and underscores one of the challenges of enforcement of security interests in the context of asset securitization.

The *locus classicus* on equitable mortgage and its mode of enforcement is *Ogundiani v. Araba*.[493] In that case, the Supreme Court held that equitable mortgages are created inter alia, (1) by mere deposit of title deeds with a clear intention that the deeds should be taken or retained as security for the loan; (2) by an agreement to create a legal mortgage and (3) by mere equitable charge of the mortgagor's property. The court further held that the last of the three classes of equitable mortgage, that is, that which is created merely by a charge on the property intended as security for the loan differs considerably from the first two in respect of the remedies it confers. This is because the property so charged is appropriated only to the discharge of a debt or some other burden in respect of which the property stands charged.

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[491] [1967] NCLR 266 at 268.
[492] Fisher and Lightwood's *Law of Mortgage* (13th edn, LexisNexis, London, 2010) 494.
[493] [1978] All NLR 165; (1978) 6-7 SC 42.

The Supreme Court further held in *Ogundiani v. Araba*[494] that where the mortgage is by way of charge, and not by conveyance, the mortgagee takes no estate whatsoever in the land or in the property but he has generally only an equitable interest to be enforced by sale upon an order of court. According to the court, the equitable charge *simpliciter* only gives a right to payment out of the property; it does not amount to an agreement to give a legal mortgage at all. Therefore, the strict mode of enforcing the charge is, however, by sale (or appointment of a receiver under an order of court) but never by foreclosure. On the other hand, as in that case where the agreement is to create a legal mortgage when required following a default in the terms of the agreement, the agreement may be enforced according to its terms notwithstanding that the legal mortgage when executed will also confer on the mortgagee an immediate power of sale. The equitable mortgage by agreement to create a legal mortgage, therefore, entitles the equitable mortgagee to something more than a mere right to payment out of the property or premises mortgaged; under the general principles, his remedies correspond as nearly as possible with those of the legal mortgagee. The Supreme Court further held that foreclosure (and not sale) is the proper remedy of an equitable mortgagee and that when an equitable mortgagee by deposit of title deeds and agreement to give a legal mortgage if called upon to do so takes foreclosure proceedings to enforce his security, the court usually decrees that the deposit operates as an equitable mortgage and that in default of payments due under the mortgage the mortgagor is trustee of the legal estate for the mortgagee and that he must convey that estate to him.

[494] [1978] All NLR 165; (1978) 6-7 SC 42.

It is submitted, with respect, that the inclusion of equitable charge of the mortgagor's property by the Supreme Court in *Ogundiani v. Araba* as a means of creating equitable mortgage is inapposite. By its legal incidents as highlighted by the Supreme Court in the case, an equitable charge is not of the same legal category as an equitable mortgage.[495]

5.4 Enforcement of Mortgage by Exercise of Power of Sale

A legal mortgagee may enforce the mortgage by exercising statutory power of sale conferred by the Conveyancing Act, 1881 and the PCL where there is default by the mortgagor. In practice, the mortgage instrument will provide the conditions for the exercise of the power and this must be complied with to make the sale effectual.[496]

Two main conditions must co-exist for a proper exercise of the power of sale. These are; that the power of sale must have arisen in the sense that the mortgage debt has fallen due; and the power of sale must have become exercisable.[497] Section 125 of the PCL provides that a mortgagee shall not exercise the power of sale conferred under the law unless and until any of these has happened:

(i) Notice requiring payment of the mortgage money has been served on the mortgagor or one or two or more mortgagors, and default has been made in payment of the mortgage money or part thereof, for three months after such service; or

(ii) Some interest under the mortgage is in arrear and unpaid for two months after becoming due; or

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[495] See I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 367-369 on the modes of creation of an equitable mortgage. Note, however, that creation of equitable mortgage by mere deposit of title deeds is no longer possible in Lagos State by s18(1) of the Lagos State Mortgage and Property Law, No. 6 of 2102.

[496] I O Smith, *Nigerian Law of Secured Credit* (n 1) 78.

[497] ibid 78-79.

(iii)There has been a breach of some provision contained in the mortgage deed or in this Law, or in an enactment replaced by this Law, and on the part of the mortgagor, or some other person concurring in making the mortgage, to be observed or performed, other than besides a covenant for payment of the mortgage money or interest thereon

It should be noted that section 126(2) of the PCL the title of the purchaser shall not be impeached on the grounds: that no cause has arisen to authorise the sale; or that due notice was not given; or that the power was otherwise improperly or irregularly exercised. The section further provides that a purchaser of the mortgaged property should not be concerned to see or inquire whether a cause has arisen to authorise the sale, or that due notice has been given or that the power is otherwise properly and regularly exercised and that damages will be the remedy of any person damnified by an unauthorised, or improper or irregular exercise of the power of sale.[498] Enforcement of mortgage will depend on whether the mortgagor still remains in default of payment of principal and interest and the determination of this is a question of agreement between the parties.

One of the practical issues that have arisen in this context is whether it is the rate of interest stated in an offer letter preceding the execution of legal mortgage that is binding on the parties or the interest rate provided in the legal mortgage. The issue arose and was determined in *Suberu v. A.I.S.L. Ltd.*[499] In that case, in September, 1996, the appellant took a loan of ₦600,000 from the respondent. Before the loan was granted, the respondent forwarded a letter to the appellant wherein it was stated that the rate of interest was to be 3% per month. It was

[498] See also section 21(1) of Conveyancing Act, 1881. See also *Africa Continental Bank Ltd v. Ihekwoaba* [2003] 16 NWLR (846) 249.
[499] [2007] 10 NWLR (Pt. 1043) 590.

also stated in the letter that the offer was subject to a deed of legal mortgage to be signed between the parties and that the interest rate was subject to review. The deed of mortgage was executed by the parties, wherein the appellant's hotel was mortgaged as security for the loan, and the interest chargeable on the facility was therein stated as 21% per annum, which was quite different from the 3% per month stated in the letter of offer. The loan was to be paid back within twelve months.

The trial court held that the guiding rate of interest in the transaction was 3% interest per month as stated in the letter of offer. On appeal, the Court of Appeal, in a unanimous decision, allowed the appeal, holding that all ancillary and preliminary agreements during negotiations, both oral and written, which are inconsistent with the provisions of the final and ultimately binding agreement are null and cannot be used to contradict the legally binding agreements. In other words, the Deed of Legal Mortgage was held to be superior over the letter of offer.

It also appears from the decision in *Suberu v. A.I.S.L. Ltd*[500] that the court will not enforce a claim where the interest rate is considered as excessive, usurious and therefore illegal where it contravened the applicable interest rate allowed by the Central Bank of Nigeria at the time of the contract.

5.5 The Land Use Act and Mortgagee's Power of Sale

The issue of whether mortgagee's exercise of power of sale is still extant after the Land Use Act 1978 (LUA), even though not yet a matter of judicial contest and decision, has been

[500] [2007] 10 NWLR (Pt. 1043) 590 CA at 605 per Muntaka-Coomassie JCA.

raised in academic circle and it is apposite to examine the opposing contentions in this regard.[501] This issue was first highlighted Umezulike[502] in a critical comment of the decision of the Court of Appeal in *Enterprise Bank Ltd v. Aregbesola.*[503] In that case, the Court of Appeal invalidated an exercise of power of sale by a mortgagee on the ground that the sale was carried out at undervalue and that there was collusion. Umezulike, however, submits that the major problem with the judgment is that it did not give any reflection on the effect of section 51 of the LUA on the mortgagee's exercise of power of sale, that is, if that power is still extant or extinguished. He further submits that that mortgagee's power of sale has been clearly extinguished under the LUA and that, therefore, whether or not there has been a sale at an undervalue or overvalue are no longer of any moment.[504] The commentator adverts his mind to the importance of mortgage and the need to ease in its realization and submits:

> "It would therefore sound startling and confusing in this castined climate to submit or contend that the mortgagee's exercise of power of sale as a final remedy has been abolished by the Land Use Act. But in strict law that is the legal position in Nigeria today. And the courts are bound in oath to give berth or effect to the provisions of laws or stautes."

In making out his argument in support of the contention that mortgagee's exercise of power of sale has been abolished under the LUA, the commentator placed reliance on the definition of "holder" in section 51(1) of the LUA[505] which provides:

> "holder" in relation to a right of occupancy, means a person entitled to a right of occupancy and includes any person to whom a right of occupancy has been validly assigned or has validly passed on the death of a holder but does not include any person to whom a right of occupancy has been sold or transferred without a valid assignment, nor a mortgagee, sublesse or sub-underlessee;"

[501] See, I A Umezulike, 'Our Grouse with Enterprise Bank Ltd and Another v. Emma Bayo Aregbesola and 2 Others (2013) 30 JPPL 149-158 and I O Smith, 'The Supposed Exclusion of Mortgagee's Power of Sale by the Land Use Act: A Response to Hon. Justice Umezulike's Review of Enterprise Bank & Ano. v. Aregbesola & 2 Ors.' (2013) 31 JPPL 143-153.
[502] I A Umezulike, *Our Grouse with Enterprise Bank Ltd and Another v. Emma Bayo Aregbesola* (n 501) 149-158.
[503] Suit No. CA/B/10/2007 delivered on Monday the 3rd of December, 2012.
[504] I A Umezulike, *Our Grouse with Enterprise Bank Ltd. and Another v. Emma Bayo Aregbesola* (n 501) 149 at 155.
[505] Cap L5, Laws of the Federation of Nigeria, 2010.

Umezuilike contends that in view of the exclusion of mortgagees as holders of right of occupancy, the mortgagee has no title to vest in the third party upon a purported exercise of a power of sale in view of the rule of *nemo dat quod non habet* (you cannot give what you do not have). His Lordship submitted:[506]

> "The basis upon which the mortgagee could transfer the mortgaged property to a third party purchaser is upon his holding of a right of occupancy over the mortgaged security by deed. If statutorily the mortgagee is not regarded or recognized as a holder of right of occupancy, then, of course he has absolutely nothing to transfer to the third party purchaser under his exercise of power of sale."

He therefore suggests that Section 51 of the LUA should be amended to remove the exclusion of a mortgagee as one of the holders of right of occupancy. He concludes that until this is done a mortgagee cannot lawfully exercise his power of sale over the mortgaged property.[507]

In his quick response to the above contention, Smith[508] contends that the LUA has not extinguished the mortgagee's power of sale. He submits that the exclusion of mortgagees from the definition of holder of right of occupancy solely relied upon by Umezulike is in *tandem* with the position of the mortgagee under the general law.[509] According to Smith, notwithstanding that in equity, the real owner of the mortgaged property remains the mortgagor, the common law as well as local statutes still recognise the mortgagee's power of sale, in spite of the nature of his interest which is as a beneficial owner whose interest in the property is merely as a security for the loan advanced to the mortgagor. He further submits that there should be no dispute about the fact that the provision of section 51(1) has clearly evinced the intention of the legislature.

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[506] I A Umezulike, *Our Grouse with Enterprise Bank Ltd. and Another v. Emma Bayo Aregbesola* (n 501) 149 at 156.
[507] ibid, 149 at 156.
[508] I O Smith, *The Supposed Exclusion of Mortgagee's Power of Sale by the Land Use Act* (n 501) 143-153.
[509] ibid, 143 at 146.

Smith further contends that section 48 of the LUA preserves the power of sale vested in the mortgagee by statute and that the mortgagee always has a license not only to sell but also to vest legal title in the purchaser. He therefore submits that "when the mortgagee exercises a power of sale and conveys title to the purchaser under a mortgage agreement or by virtue of some statutory provisions, he does so not as a "holder" (as he does not qualify as such under the Act), but as an "agent" of the mortgagor- the "holder", with a licence to sell and convey title to the third party upon sale."[510] He further submits that the practical implication of the argument of Umezulike on the effect of exclusion of mortgagees from definition of holder of right of occupancy will be that a mortgagee will also be relieved of obligations of obtaining governor's consent to alienation of right of occupancy under section 22 of the LUA as the section expressly mentioned "holder" to be under the obligation created by the section. Smith, however, points out that Umezulike would not agree with this proposition[511] and submits:

> "The only way out of this conundrum is an appreciation of the argument that the mortgagee, as the agent of the mortgagor with a license to sell the property the subject matter of the mortgage upon the default by the mortgagor, transfers the mortgagee property subject to the restrictions of the Land Use Act placed on such alienation by the holder on whose behalf the transfer to the third party purchaser is made by the mortgagee."

The contention of Umezulike would also have far reaching negative implications for enforcement of other remedies available to a mortgagee. Smith submits that an enforcement of other remedies such as foreclosure, entering into possession or appointment of receiver are already frustrated by the argument of Umezulike. According to him:[512]

> "In the case of a legal mortgage such as the case in Aregbesola's case, it is unlikely, following the argument of the commentator, that the mortgagee who is

[510] ibid at 148.

[511] See, I A Umezulike, *ABC of Contemporary Land Law in Nigeria* (n 467) 323 -324, where he contends that foreclosure and exercise of power of sale involve transfer of property envisaged under section 22 of the Land Use Act and forbidden without the consent of the Governor.

[512] I O Smith, *The Supposed Exclusion of Mortgagee's Power of Sale by the Land Use Act* (n 501) 143 at 153.

> not a holder of a right of occupancy would have been able to foreclose since he would have no title to enlarge; or to enter into possession since he would not have title which entitles to possession; and may not be able to exercise the statutory power to appoint a receiver for the same reason except, of course, where the power to appoint a receiver is contractual."

The contention by Smith appears more plausible and is hereby adopted by this work. Additional to the contentions by Smith, it is submitted that the heavy reliance on the rule of *nemo dat quoud non habet* by Umezulike fails to take cognisance that the law has always recognised exemptions, particularly by statutory provisions, to the *nemo dat quoud not habet rule*. As rightly submitted by Smith, the mortgagee's power of sale is not predicated on recognition of the mortgagee as the real owner of the mortgaged property by the mortgagee, but on applicable law. The source of power of sale by a mortgagee is not by virtue of ownership vested in him but under express power of sale in the mortgage or statutory power of sale introduced by Lord Cranworth's Act 1862.[513] These statutory power of sale are now domesticated in the laws applicable in the various states and are preserved by section 48 of the LUA as rightly submitted by Smith.

5.6 Challenging Exercise of Power of Sale

Decided cases show that one of the areas of challenge to enforcement of mortgage security by exercise of power of sale by the mortgagees is that mortgagors often contest the exercise of the power, in some cases, quite justifiably and in many on frivolous grounds to frustrate the realisation of the security.

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[513] See, Fisher and Lightwood's *Law of Mortgage* (n 492) 657.

The facts and the decision in the case of *Agboola v. U.B.A Plc*[514] provide an illustration of contrived attempt to frustrate the exercise of power of sale by a mortgagee. In the case, the appellant as plaintiff in the High Court sued to challenge the sale of the mortgage property by the Respondents. The appellant claimed ownership of the mortgaged property alleging that the property was mortgaged by the 3rd respondent, with whom she allegedly kept the title documents, without her knowledge. The receipt tendered by the appellant obviously contrasted with her pleading. It is also clear that the appellant contrived the case possibly with the 3rd Respondent to frustrate the enforcement of the mortgage security.

The Supreme Court was able to see through the contrivance and in a unanimous decision dismissed the case of the appellant. The Supreme Court held that the court will be wary to set aside an auction sale where the scenario indicates that the under mentioned facts are shown to the satisfaction of the court to the present:

a. that the mortgagor did mortgage the property in dispute to the mortgagee;
b. that the loan or any instalment thereof has become payable;
c. that notice of demand of repayment of the loan from the mortgagee to the mortgagor;
d. that the power of sale under the mortgage agreement has arisen;
e. that the precondition of notice of sale is given to the mortgagor by the mortgagee or his agent;
f. that the power of sale was exercised and the title in the property passed to the purchaser.

[514] [2011] 11 NWLR (Pt. 1258) 375.

It was further held that where there is prayer to set aside an auction sale of a mortgaged property, the court must remember that the mortgagee is not a trustee of a power of sale for the mortgagor except for the balance of the purchase money. It is a power given to him for his benefit, enabling him to protect the mortgage debt. The Supreme Court also held as regards proper procedure to challenge auction sale of land that the appropriate remedy for a third party who is challenging an auction sale of land on the ground that the defendant has no title to the property sold and that valid title is vested in him (the third party) is by bringing an action for declaration of title which is the procedure the appellant herein adopted. As regards necessary parties, the Supreme Court held that where it is sought to set aside the sale of mortgaged property or to declare the sale null and void, the purchaser ought to be made a party. This is because any order made in favour of the plaintiff will adversely affect the purchaser.

Another point of challenge by mortgagors is as regards non-compliance with the requirements of sale by auction law. It appears however that where the subject matter of the mortgage of land, the court will read the provision of Sale by Auction Law with the provisions of the Conveyancing Act, where applicable. Thus, in *Salami v. Wema Bank*,[515] the appellant has argued that section 19 of the Public Auction Law of Lagos State[516] ought to be strictly applied. The section reads thus:

[515] [2010] 6 NWLR (Pt. 1190) 341.
[516] Cap 173 laws of Lagos State 1994.

> No sale by auction of any level shall take place until after at least seven days public notice thereof has even given in the city of Lagos and also at the place of the intended sale.
> The notice shall be made not only by printed or written document but also by beat of drum or such other method intelligible to uneducated persons as may be prescribed, or if not prescribed as the state commissioner may direct and shall state the name and place of residence of the seller.

The court held that to the extent that sale by public auction is not limited to land matters, the appellant's contention is right. But where such a sale relates to property to which the Conveyancing Act 1881 applies, the Public Auction Law of Lagos State must be read subject to the provisions of the Act. Section 21 of the Conveyancing Act 1881 provides as follows:

> 21(1) Where a conveyance is made in professed exercise of the power of sale conferred by this Act the title of the purchaser shall not be impeached on the ground that no case has arisen to authorize the sale, or that due notice was not given or that the power was otherwise improperly or irregularly exercised, but any person damnified by an unauthorized or improper or irregular exercise of power shall have his remedy in damages against the person exercising the power,

The court further held that the interplay between the provisions of section 21(1) of the Conveyancing Act and the provisions of Auction Law in most states which are all similar to section 19 of the Public Auctions Law of Lagos State and their effect on each other have been so dealt with in a long line of cases as to become trite[517] and that in all these cases both the Court of Appeal and the Supreme Court have held that section 21(1) of the Conveyancing Act is applicable to property purchased through auction sale. The strict provisions of section 19 of the Public Auction Law of Lagos State do not apply to auction sales involving property to which section 21 of the Conveyancing Act applies. Therefore, a purchaser, having purchased in an auction property to which the Conveyancing Act applies, the sale cannot be avoided by any irregularity that may have attended the process of sale unless there is established *mala fides* against the purchaser in the form of fraud or collusion. Allegation of fraud or collusion

[517] The court referred to *Sanusi v. Daniel* [1956] SCNLR 288, *Okonkwo v. C.C.B. Nig Plc* [2003] 8 NWLR (Pt. 822) 347, *Africa Continental Bank Ltd v. Ihekwoaba* [2003] 16 NWLR (Pt. 846) 249; *Wema Bank Plc v. Abiodun* [2006] 9 NWLR (Pt. 984) 1 and *Ibiyeye v. Fojule* [2006] 3 NWLR (Pt. 968) 641.

must not only be pleaded by the party seeking to set aside the sale but same must be proved by cogent evidence.[518]

The remedy available to mortgagor where there is irregularity in auction sale of mortgaged property is essentially in damages from the mortgagor. The title of the purchaser to the property cannot be impeached by the irregularity in the conduct of the sale.[519]

There is also the tendency by mortgagors to challenge sale of mortgaged property by auction on the ground that the sale was effected at undervalue. In this regards, in *Okonkwo v. C.C.B. Nig. Plc*,[520] Tobi JSC noted:

> In an auction sale, the mortgagee who has a major interest in the property is entitled to promote and take care of his interest in the sale. In an auction sale, the interest of the mortgagee is paramount and as long as the sale is conducted bona fide, a mortgagor has no legal basis to complain in respect of, or about a low price. Auction sale by its very commercial nature presupposes some reduction of the market price value as dictated by the price index. The auctioneer, in order to dispose of the goods, should attract the public by a lower price. As long as the price is not ridiculously low or grossly undervalued as to suggest a possible fraud or collusion amongst the mortgagee, the auctioneer and the buyer, the mortgager has no legal ground to complain........ A price for the goods in an auction cannot compete favourably with the correct market value of the goods."

Where the mortgaged property is sold at a price showing an accretion in value, the court will not agree that the property has been sold at under value.[521]

Fraud may be another ground for challenging exercise of power of sale. However, mortgagee's right to enforce the mortgage will not be restrained where the mortgagee has no notice of fraud perpetrated by the mortgagor in mortgaging the property.[522]

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[518] See *Salami v. Wema Bank* [2010] 6 NWLR (Pt. 1190) 341 CA.
[519] *Mohammed v. Abdulkadir* [2008] 17 NWLR (Pt. 1076) 111; See also *Africa Continental Bank Ltd. v. Ihekwoaba* [2003] 16 NWLR (Pt. 846) 249.
[520] [2003] 8 NWLR (Pt.822) 347 at 422-423.
[521] *Abdulrahman v. Oduneye & Ors* [2009] 17 NWLR (Pt. 1170) 220 CA.

It is submitted that there is good policy sense in the court exercising caution in refusing to give effect to secured transactions, particularly mortgages. In *Abdulrahman v. Oduneye,*[523] Agbo, JCA, stated:

> "I am aware of the housing crisis in the country today and we need the finance institutions to avail the public with financing for both housing and other major business transactions. This financing is mainly secured by mortgage transactions. If for every flimsy excuse the courts avoid the execution of mortgaged deeds, the financial institutions will be reluctant to extend credit to the public and the overall economy will be the loser,"

5.7 Use and Abuse of Interim and Interlocutory Injunctions to Restrain Enforcement of Security Interests

Apparently to protect the mortgagor, an application for an order of interim or interlocutory injunction may be brought to restrain the mortgagee from enforcing the security by sale. The following circumstances have been highlighted by Smith as the circumstances when such application may be brought: where power of sale has not arisen or become exercisable; where the mode of sale contemplated by the mortgagee deviates from the mode prescribed by the mortgaged instrument; where prevailing circumstances give rise to estoppel; and where mortgage is a fraud or the mortgage deed is not executed.[524]

Generally, the law is that a mortgagee will not be restrained in the exercise of his power of sale merely because the mortgagor objects to the manner in which the sale is being arranged or because the mortgagor commenced a redemption action in court.[525] The mortgagee will however be retrained if the mortgagor pays the amount claimed by the mortgagee into court. Therefore, the sale of the mortgaged property after a mortgagor had tendered bank draft for

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[522] See: *Oti v. Oti* [2002] 13 NWLR (Pt. 785) 629 CA.
[523] [2009] 17 NWLR (Pt. 1170) 220 CA at page 237, paras. C-D.
[524] I O Smith, *Nigerian Law of Secured Credit* (n 1) 90-92.
[525] *Nigerian Housing Development Society v. Mumuni* [1977] 2 S.C. 57.

payment of indebtedness would be held null and void as same could not have been done in good faith without collusion with the purchaser.[526]

However, one of the observed challenges of enforcement of security interests in Nigeria is improper use of injunctive reliefs, particularly interim and interlocutory injunctions. A mortgagor who defaults in the settlement of his mortgage debt may not be entitled in law to restrain the mortgagee from exercising his right of sale. However, where the application is an interlocutory application pending the hearing and determination of the substantive suit or appeal, a mortgagee could be restrained from exercising his power of sale. This is supported by the rules of court which provides that the courts shall have powers to make orders by way of injunctions or appointment of receiver or manager and such other necessary orders for the protection of property or persons pending the determination of an appeal to the Court of Appeal, even though no application for such an order was made in the trial court. It is important to note however that this is at the discretion of the court.[527]

It is often the experience that a mortgagor will rush to court to obtain interim and interlocutory injunctions against the exercise of power of sale or even appointment of receiver and then drag on the matter for years up to the Court of Appeal and the Supreme Court.

[526] *Nigerian Advertising Services Ltd v. United Bank for Africa Plc* [2005] 14 NWLR (Pt. 945) 421.
[527] *Ndaba Nigeria Limited v. Union Bank Nigeria Plc* [2008] All FWLR (Pt. 436) 1945.

5.8 Enforcement of Land Based Security Interests and Governor's Consent

It appears settled law that failure to obtain governor's consent to qualifying land based transactions by section 22 of the LUA renders same void under section 26 of the Land Use Act. In *Olalomi Ind. Ltd v. N.I.D.B. Ltd*,[528] the Supreme Court held that the provision will be given effect even though it was the mortgagor that did not obtain proper consent and benefited from the secured transaction. It was held that although the appellant who was complaining of the illegality of the document, applied for and got the consent, submitted same to the respondent and received a loan, the express provisions of the LUA make it undesirable to invoke the maxim *ex turpi causa non oritur actio* and the equitable principle enshrined in the case of *Bucknor-Maclean v. Inlaks*[529] that it will be unconscionable to allow a party to resile from a transaction that he has benefitted from.

There may however be contentions as to which instrument requires the consent of the Governor. In *Olalomi Ind. Ltd v. N.I.D.B. Ltd*,[530] it was held that a letter of approval of working capital loan by a bank to its customer is not a document affecting land whereby any interest in any land is conferred, transferred, limited, charged or extinguished to fall within the scope of documents defined as instrument under the Land Registration Law of Kwara State. It does not qualify as 'instrument' such as to require the consent of the Governor or to be registered. The Supreme Court also held that a deed of debenture freely executed creating a charge over a company's floating assets does not require the Governor's consent to be valid.

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[528] [2009] 16 NWLR (Pt. 1167) 266.
[529] [1980] 8-11 SC 1.
[530] [2009] 16 NWLR (Pt. 1167) 266.

According to the Supreme Court, it did not create any charge on land. As such, it did not require the Governor's consent to be valid.

The onus is on a mortgagor or anybody claiming through him to establish that the mortgage property has been redeemed.[531] Thus, while it is the case that a mortgagor has a legal right to redeem his property once the mortgaged debt is fully paid, the mortgagor should require the mortgagee to execute a deed of release for the mortgagor when the debt is fully paid. This is because a deed of release is affirmative evidence that a mortgaged property was redeemed. In *Jolasun v. Bamgboye*,[532] it was held that the respondent's oral evidence that the land was redeemed from mortgage was not credible in the absence of a deed of release or documentary evidence indicating full payment of the mortgage debt by his father.

It is now generally accepted that the combined effect of sections 22 and 26 of the LUA rendering null and void any form of alienation of right of occupancy in respect of landed property without requisite consent has become a clog in the wheel of progress of land based security interests. The present writer has examined the negative practical effect of the position of Nigerian law on effect of failure to obtain consent, particularly on secured transaction[533] of the decision of the Supreme Court in *Calabar Central Cooperative Thrift and Credit Society*

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[531] *Jolasun v. Bamgboye* (2010) 18 NWLR (Pt. 1225) 285.
[532] supra
[533] A Basiru, 'Savannah Bank v. Ajilo Resurges in full force: A Review of Calabar Central Cooperative Thrift and Credit Society Ltd & 2 Ors v Bassey Ebong Ekpo' A. R. Vol. 1, No. 2, Dec. 2009/Jan.2010, 159.

Ltd & 2 Ors v. Bassey Ebong Ekpo.[534] The outline of the submissions of the present writer is set out below. [535]

To the extent that the decision in *Calabar Central Cooperative Thrift and Credit Society Ltd v. Bassey Ebong Ekpo*,[536] states a general proposition of law on the effect of failure to obtain requisite consent, the decision is liable to criticism. It appears that the Supreme Court simply relied on its earlier decision in *Savannah Bank v. Ajilo*,[537] which has been the subject of many critical comments.[538] By so doing, the Court did not consider its own pronouncements in subsequent cases such as *Adedeji v. National Bank*,[539] *Awojugbagbe Light Industries Ltd v. Chinukwe*[540] and *Ugochukwu v. Cooperative and Commerce Bank Ltd*,[541] all of which interpreted and applied sections 22 and 26 of the LUA in accordance with the demands of justice and equitable doctrines.

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[534] [2008] 33 NSCQR (Pt. II) 1146, SC; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.

[535] A Basiru, *Savannah Bank v. Ajilo Resurges in full force* (n 533).

[536] [2008] 33 NSCQR (Pt. II) 1146, SC; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.

[537] [1989] 1 NSCC 135; [1989] 1 SCNJ 169; [1989] 1 NWLR (Pt 97) 305. See also *Jacobson Engineering Co. v. UBA Ltd* [1993] 3 NWLR (Pt. 283) 586; *Ogbo v. Adoga* [1994] 3 NWLR (Pt. 333) 469; *Mainagge v. Gwamma* [1997] 11 NWLR (Pt. 528) 191; *Ezenwa v. Oko* [1999] 14 NWLR (Pt. 637) 95.

[538] See R A Onuoha, 'Governor's Consent under Section 22 of The Land Use Act: The Position Since Savannah Bank v Ajilo' in I O Smith (ed.) *Land Use Act Twenty Five Years After* (Faculty of Law University of Lagos, Lagos, 2003). 198 and articles referred to in footnote 2 thereof.

[539] [1989] 1 NWLR (Pt. 96) 212.

[540] [1993] 1 NWLR (Pt. 270) 485.

[541] [1996] 6 NWLR (Pt. 456) 524. In *Ugochukwu v Cooperative and Commerce Bank Ltd*, the mortgagor contended that the consent given to the transaction by a state Commissioner was void. The Supreme Court held that by section 45(1) of the Land Use Act the State Governor can delegate his powers under the Act to a State Commissioner and that this had been done in that case. The Supreme Court, however, further held, per Belgore JSC, (at p. 540) that: "The holder of a right of occupancy, evidenced by a certificate of occupancy, is the one to seek the consent of the Governor to alienate, transfer, mortgage etc. There is no doubt the consent given on Exhibit 3 was at the instance of the appellant who was in need of fund from the respondent by way of mortgage. It is not from him that one must hear that the consent he obtained was void. *Solanke v Abed* (1962) 1 SCNLR 371; (1962) 1All NLR 230; *Oilfield Supply Center v Johnson* [1987] 2 NWLR (Pt. 58) 625; *Savannah Bank (Nig.) Ltd v Ajilo* [1989] 1 NWLR (Pt. 97) 305. The Appellant, being the holder of the right of occupancy over the house, i.e. No. 239 Cameroun Road, Aba, was to seek consent and it is unconscionable for him to turn round and maintain that the consent of the Governor he obtained was flawed, having received valuable consideration i.e. the loan from the Respondent.

The Supreme Court had, in *Ugochukwu v. Cooperative and Commerce Bank Ltd*,[542] expressed the view that someday the Court would have the opportunity to revisit the case of *Savannah Bank v. Ajilo* because "to allow a mortgagor to resile from his liability on the grounds of his failure to do that which the law enjoins him to do will only result in paralysis of the economic activities in this country. This court, I dare say, will not allow such a situation to arise".[543] However, that regrettably, the Supreme Court did not reconsider its position in *Savannah Bank v. Ajilo* in *Calabar Central Cooperative*[544] and that it was strange that the Supreme Court did not consider its earlier decisions in *Awojugbagbe Light Industries Ltd v. Chinukwe*[545] and *Ugochukwu v. Cooperative and Commerce Bank Ltd.*[546] It would appear that what the Supreme Court did in *Calabar Central Cooperative*[547] was simply to resurrect the position in *Savannah Bank v. Ajilo* without regard to the qualifications which the Court had made to the decision in the subsequent cases.

The present writer therefore submitted:

> With respect, a decision of the Supreme Court, as a matter of law, binds it and other courts in the country. It is a principle that is erected on the doctrine of *stare decisis*, which, for its effectiveness, demands certainty. It is thus submitted that the Supreme Court ought to have averted its mind to its earlier decisions, particularly *Awojugbagbe Light Industries Ltd v Chinukwe*, even if only to distinguish the case from the facts of the instant case. Even though the Court has the power to depart from its previous decision in the interest of justice, if and when circumstances so dictate, it does not augur well for the development of case law in Nigeria for the Supreme Court to make a decision without at least referring to and considering

542 [1996] 6 NWLR (Pt. 456) 524, SC, per Ogundare, JSC at 542.

543 supra.

544 [2008] 33 NSCQR (Pt. II) 1146, SC; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362. Indeed, in the lead judgment, Onnoghen, JSC held that the Court is not prepared to examine the argument whether the Respondent should be allowed to benefit from his wrong as according to His Lordship, there was no alternative prayer to that effect in the lower court. In his concurring judgment, Tobi, JSC also held that arguments predicated on the need to do justice will not avail the appellant as, according to His Lordship, "a court of law cannot ignore provisions of a statute which are mandatory or obligatory and toe the line of justice in the event that the statute has not done justice. Courts of law can only do so in the absence of a mandatory or obligatory provision of a statute". See [2008] 1-2 SC 229 at 259-260

545 [1993] 1 NWLR (Pt. 270) 485.

546 [1996] 6 NWLR (Pt. 456) 524, SC, per Ogundare, JSC at 542

547 [2008] 33 NSCQR (Pt. II) 1146, SC; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362

> its earlier relevant decisions, even if only to distinguish, explain or expressly overrule them. Even though in the light of pronouncements of some of the Justices in the case of *Calabar Central Cooperative,* it may be argued that a land based transaction may be held to be inchoate if there is pleading and evidence to that effect, it is safe, in view of the actual decision in the case, to take the position that failure to obtain consent will not render the transaction inchoate but null and void a la *Savannah Bank v Ajilo* as reconfirmed in *Calabar Central Cooperative.*[548]

It was further submitted that failure by the Supreme Court to expressly consider and overrule its previous decisions like *Awojugbagbe Light Industries Ltd v. Chinukwe*[549] and *Ugochukwu v. Cooperative and Commerce Bank Ltd*[550] in the case of *Calabar Central Cooperative*[551] may lend support to the view that there are conflicting opinions of the Supreme Court on the issue of failure to obtain consent to cognizable transactions under the Land Use Act. Although, the position in the case of *Ugochukwu v. Cooperative and Commerce Bank Ltd*[552] is that it will be unconscionable to declare a transaction null and void at the instance of a party whose duty it was to obtain same,[553] the position in other cases like *Savannah Bank v Ajilo, Union Bank of Nigeria Plc v. Ayodare & Sons (Nig.) Ltd*[554] and *Calabar Central Cooperative*[555] is that the transaction will be null and void irrespective of the party raising the issue of lack of consent. Also, while the decision in *Awojugbagbe Light Industries Ltd v. Chinukwe*[556] is that the transaction will be inchoate pending the grant of the requisite consent, the decision in *Calabar*

[548] A Basiru, *Savannah Bank v. Ajilo Resurges in Full Force*, (n 533) 159.
[549] [1993] 1 NWLR (Pt. 270) 485.
[550] [1996] 6 NWLR (Pt. 456) 524, per Ogundare, JSC at 542.
[551] [2008] 33 NSCQR (Pt. II) 1146, SC; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.
[552] [1996] 6 NWLR (Pt. 456) 524, per Ogundare, JSC at 542.
[553] See also *Solanke v. Abed* [1962] 1 All NLR 230; [1962] 1 SCNLR 371.
[554] [2007] 13 NWLR (Pt. 1052) 567 at 602-603 adopting the position of Musdapher, JCA in the court below in the same case.
[555] [2008] 33 NSCQR (Pt. II) 1146; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.
[556] [1993] 1 NWLR (Pt. 270) 485.

Central Cooperative[557] is that the transaction is not inchoate but null and void for all purposes.

In the recent case of *Pharmatek Industrial Projects Ltd v. Trade Bank Nig Plc*,[558] Nweze, JCA also pointed out "what, with profound humility and due deference, may, with all trepidation, be called conflicting opinions of the apex court."[559] The present writer shares the view later articulated by the learned Justice of the Court of Appeal to the effect that, when and if the opportunity arises in the near future, the Supreme Court should reconcile or harmonise the said opinions and issue a definitive position for the guidance of the courts, academics and financial community.

The practical effect of the decision in *Calabar Central Cooperative*[560] will be that lenders ought to wait for consent to be granted to a land-based security transaction for the transaction to be valid. Also, the practical consequence of this decision becomes even graver in view of the Supreme Court decision in *Union Bank of Nigeria Plc v. Ayodare & Sons (Nig.) Ltd,*[561] upholding the decision of the Court of Appeal in that case, that mortgagees ought to ensure that the mortgage has proper consent "before executing the deeds and parting with their money". As this decision seems to suggest, having to wait to obtain consent even before loan disbursement and land-security transaction will undoubtedly prolong the time for closing such a deal with attendant cost implications.

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557 [2008] 33 NSCQR (Pt. II) 1146; [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.
558 [2009] 13 NWLR (Pt. 1159) 577 at 615-6.
559 [2009] 13 NWLR (Pt. 1159) 577 at 615-6. In fact, His Lordship held that it is part of the duty of the Court of Appeal, as the penultimate court, to point out conflicting decisions of the apex court with due deference.
560 [2008] 33 NSCQR (Pt. II) 1146, [2008] 1-2 SC 229; [2008] 6 NWLR (Pt. 1083) 362.
561 [2007] 13 NWLR (Pt. 1052) 567 at 602-603 adopting the position of Musdapher, JCA in the court below in the same case.

Given the centrality of land-based security transactions to the Nigerian economy, it is obvious that a position which requires parties to obtain consent before mortgage of land is inefficient. It is submitted that the decision in *Union Bank of Nigeria Plc v. Ayodare & Sons (Nig.) Ltd,*[562] not only represents a shift from the earlier position of the Supreme Court that the obligation to obtain consent is on the mortgagor[563] but would operate as a hindrance to the efficiency of land based security transactions.

Furthermore, the astonishing implication of this decision becomes all the more real considering the elaborate, cumbersome and costly procedure for obtaining consent.[564] In fact, as is the case with Lagos State, the government has turned the requirement of consent into a cash cow, thereby making the cost of access to credit on a secured basis rather prohibitive. Therefore, the decision will not only operate to stifle secured credit transactions on land but is a clear disincentive to the realization of an efficient security interest system in Nigeria. This is aside from the fact that it will provide an opportunity for many debtors who offered security to abdicate their responsibility, particularly in view of the fact that the procurement of consent

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562 [2007] 13 NWLR (Pt. 1052) 567.

563 See, for example, *Owoniboys Technical v. Union Bank of Nigeria* [2003] 40 WRN 1 at 21, per Ejiwunmi, JSC.

564 The following is the list of documents, procedure and payments involved in the perfection exercise in Lagos State: Application Form 1C, obtainable in the Consent Section at the Land Bureau; certified true copy of the assignor's document of title duly obtained from the Lands Registry at the Secretariat; current tax clearance certificates of the two parties (in case of mortgages, only the mortgagor's tax clearance certificate is required. Where one of the parties is a limited liability company, the Internal Revenue certificate of PAYE for its staff and current tax clearance certificate for the directors should be attached); in case of a developed land, the process will be facilitated if application is accompanied with the building plan of the property and tenement rate receipt (an affidavit in lieu of tenement rate will suffice where the land is undeveloped); where the land is a State Land or covered by a Certificate of Occupancy, evidence of payment of ground rent and land charges up to date should be produced; ₦100.00 Economic Development Levy receipt for the two parties; six counterparts of the duly executed deed of assignment or deed of mortgage (duly franked); ₦7,500.00 made payable to the Lagos State Government as Charting Fee; ₦1,500.00 made payable to Lagos State Government as Endorsement fee; ₦1,500.00 made payable to Lagos State Government for Form 1C; in the case of a mortgage, 0.02% of the mortgaged loan is payable as consent fee; an amount equal to 15% of the capital value of the property or land, the breakdown of which is as follows: consent fee - 8%; capital gains tax - 2%; stamp duty - 2%; registration - 3%. See M A Banire, *Land Management in Nigeria: Towards a New Legal Framework* (Ecowatch Publications (Nig) Ltd, Lagos, 2006) 195-197.

requires the cooperation of such debtors.[565] Alternatively, a creditor may simply refuse to advance any credit until the lender shows evidence of the requisite consent.[566]

The awkward position that the court may find itself is well articulated by Nweze, JCA (as he then was) in *Pharmatek Industrial Projects Ltd v. Trade Bank Nig Plc*[567] that:

> ...I endorse the findings of the lower court that the appellant's conduct had all the trappings of chicanery, nay more, outright obliquity! However, unlike the said lower court, I have no choice than to allow it to benefit from its own perfidious pranks. It is an unfortunate situation but, according to the Supreme Court in *U.B.N. v Ayodare* (supra), that is the law. Here the appellant has effectively exploited the stringent provision of section 26 (supra) to perpetrate an unconscionable act and, thus, brazenly spite the inveterate doctrines of equity! The draftsmen of the English Judicature Act 1873 and 1875 must be stirring in their graves!

Furthermore, insistence by the courts on the stringent application of the consequence of lack of consent on asset securitization resulted in additional due diligence requirements being placed on secured lenders as well as on professionals engaged to structure asset securitization. Nweze JCA, in *Pharmatek Industrial Projects Ltd v. Trade Bank*[568] highlighted this implication when he wrote:

> "On their part, secured creditors must henceforth painstakingly examine such consent letters purporting to convey approval of their mortgage transactions with the finery of a toothcomb. Hence, the new maxim in all secured credit transactions should be: Creditors beware!"

The practical implications of this may make asset securitization unattractive where the underlying security interests is land based both from the perspective of the cost and time for requisite due diligence. It is, therefore, suggested that at least secured transactions should be excluded from the consent provisions under the Land Use Act.

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565 A more recent example is the case of *Pharmatek Industrial Projects Ltd v. Trade Bank Nig Plc* [2009] 13 NWLR (Pt. 1159) 577.

566 For additional criticism of the decision in *Union Bank of Nigeria Plc v. Ayodare & Sons (Nig.) Ltd* [2007] 13 NWLR (Pt. 1052) 567, see I O Smith, 'Statutory Requirement of Consent in Mortgage Transactions as an Instrument of Fraud in Nigeria (2005-2009) vol. 26 JPPL 18.

567 supra at 628.

568 supra at 626, para. H.

5.9 Challenges of Receivership as a Mode of Enforcement of Security

Receivership or appointment of receiver is another mode of enforcement of security interests under Nigerian Law. Even though not restricted to security interests created by companies,[569] appointment of receiver is by far widely used in enforcement of security created by companies, particularly floating charges.

Clearly it is unnecessary for a receiver appointed out of court to again apply to court before it can act. In *Dagazau v. Bokir International Co. Ltd,*[570] the Court of Appeal held that there is a difference between the latitude enjoyed by a receiver appointed out of court under section 391 of CAMA and the one appointed by court.

One of the drawbacks of enforcement of security interests is that even in situations where the enforcement remedy can ordinarily be carried out as a self-help remedy without recourse to court, as for instance appointment of receiver/manager under Debenture Trust Deed, lenders and/or their agents still have to go to court for assistance of the court to restrain the defaulting borrower or its agents from interfering with, obstructing or frustrating the receiver/manager. This was found necessary in practice because of the hostility usually displayed against lender by the defaulting borrower and the fact that even law enforcement agents do not want to assist out of court enforcement of security. The practical effect of this is further exposure to cost of litigation as well as unnecessary delay in realizing the security. An illustrative case in this regard is *Onafowokan v. Wema Bank Plc*[571] which spanned from the ruling at the High Court

[569] See I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 408-414 on appointment of receiver in the context of enforcement of mortgages generally.
[570] [2011] 14 NWLR (Pt. 1267) 261.
[571] [2011] 12 NWLR (Pt. 1260) 24.

in February 2001 to Supreme Court Judgment on the preliminary objection in May, 2011, that is, a period of about ten years. The case of *Unibiz Nigeria Ltd. v. Commercial Bank Credit Lyonnais*[572] discussed below also exemplifies this situation.

5.9.1 The Use and Abuse of Preliminary Objection in Enforcement by Receivership

The case of *Onafowokan v. Wema Bank Plc*[573] is illustrative of the possibility of the use and abuse of preliminary objection to frustrate or delay an action for enforcement of security by receivership. In the case that was filed at the Federal High Court on 11 April, 2000, the Appellants/debtors upon being served with the writ of summons and the statement of claim, without filing a statement of defence reacted by filing a notice of preliminary objection to the competence of the action contending that the trial court lacked jurisdiction to adjudicate over the matter because the plaintiffs has no *locus standi* to institute the action. The trial court upheld the preliminary objection and struck out the action on 9th February, 2001. Upon appeal, the Court of Appeal in a judgment delivered on 25th March, 2004, set aside the decision of the trial court. The Appellant therefore appealed to the Supreme Court which delivered its judgment on 13th May, 2011 by dismissing the appeal and remitting the case to the trial court for hearing on merit by another judge. The substance of the objection of the Appellants that was dismissed eventually by the Supreme Court after about ten years was that the Respondent Receiver/Manager lacks *locus standi* to institute an action for enforcement of security because no leave was sought by the Respondent to institute the action and that the Respondent cannot seek refuge under section 393(3) of CAMA. The Appellants had

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[572] [2003] 2 SC 22.
[573] [2011] 12 NWLR (Pt. 1260) 24.

contended that the Respondents did not plead facts to enable the receiver to sue without leave being a receiver appointed for the whole of the company's property under section 393(3) of CAMA. Dismissing the objection, the Supreme Court, per Mohammed, JSC held:

> It is quite clear from the facts averred in these paragraphs that the 2nd respondent Company is indebted to the 1st respondent Bank and other Consortium of lender Banks to the tune of N311,000,000.00 as at 14th March, 2000. It is also clear that by two separate Debentures Trust Deeds executed on 14th June, 1994 and 19th September, 1996, the 2nd respondent Company created a first charge in favour of the 1st respondent and other Consortium of lending Banks over all the hereditaments buildings and property of the 2nd respondent Company including Plants, Machinery, Equipment, Warehouse, Office Block and Real Property at No. 24 Abimbola Street Ilasamaja Isolo Lagos. It is also plain from the undisputed facts averred, that the 2nd respondent was in default in paying back the loan which led to the exercise of the powers of the lenders under Clause 15 of the Debenture Trust Deed to appoint the 3rd respondent a receiver/manager over all the properties of the 2nd respondent charged under the Debenture Trust Deeds. There is no doubt whatsoever that the appoint of the 3rd respondent as a receiver/manager covers all the assets and property of the 2nd respondent charged in the Debenture Trust Deeds to secure the loan granted to the 2nd respondent. In the circumstances therefore, the appointment of the 3rd respondent is completely within section 393(3) of the Companies and Allied Matters Act for the whole or substantially the whole of the property of the 2nd respondent to qualify him to enjoy the rights specified under clause 5 of Schedule 11 of Companies and Allied Matters Act, as rightly found by the Court below.[574]

It appears that practically in this case the debenture-holders were kept in limbo from proceeding with the action to enforce the security by the preliminary objection eventually dismissed after a ten-year period of litigation from the Federal High Court to the Supreme Court.

It is instructive to note in the leading judgment, Mohammed JSC held that in that case, "the defendant/appellant acted in accordance with the law when on being served with the writ of summons and the statement of claim, without waiting to file a statement of defence brought their application to terminate the action on the main ground that the plaintiff/respondent lack *locus standi*". However, Fabiyi JSC had reservations about the preliminary objection at the stage it was taken. According to His Lordship:

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574 *Onafowokan v. Wema Bank Plc* (supra) 24.

> …Preliminary objection should not be hastily taken. The question of whether or not the Receiver is appointed for the whole or substantially the whole of the company's property and wait till later in the proceedings when evidence is adduced. A trial court should always avoid determination of issues which require tested evidence at the preliminary stage. This will obviate the adage of 'much haste; less speed.[575]

There is the contending position in Nigerian litigation circle as to whether preliminary objections of threshold issues such as absence of jurisdiction, cause of action or reasonable cause of action should be raised, considered and determined before the substantial suit or that even though the objections should be raised timeously but that the consideration and determination of the objection should be deferred and taken together with the substantial suit.

It is the general position of law that issue of jurisdiction and other threshold issues like *locus standi*[576] and cause of action should be taken first and determined before the substantive suit. The rationale for this is that it will be a waste of judicial time and resources to embark on a case where the court lacks competence.[577] It appears from available judicial authorities that whether the issue of determination of the preliminary objection is taken separately before the substantive suit or together with the substantial suit would depend on whether the action was originated by writ of summons or originating summons. In *Yar'adua v. Yandoma*,[578] the Supreme Court held that the procedure to adopt where an objection is raised to the jurisdiction of the court in a matter commenced by originating summons is to consider the objection together with the substantive matter.

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575 [*Onafowokan v. Wema Bank Plc* (supra) 58.

576 In *Airtel Networks Ltd v. George* [2015] 4 NWLR (Pt. 1448) 60 at 78, the Supreme Court held that where a plaintiff has no locus standi to bring an action the suit becomes incompetent and consequently the court lacks jurisdiction to entertain it. The Court further held that this is based on the fact that locus standi and jurisdiction are interwoven because locus standi goes to affect the jurisdiction of the court.

577 This is because a trial without jurisdiction is a nullity; *Petrojessica Enterprises Ltd v. Leventis Technical Co Ltd* (1992) 5 NWLR (Pt.244) 675 at 693.

578 [2015] 4 NWLR (Pt. 1448) 123.

The present writer is of the view that this trend should be adopted by our courts in actions for enforcement of security interests as it will remove the many frustrations faced by secured lenders particularly in view of time value of money. The present writer suggests that there should be specific provisions in the law that preliminary objections in actions for enforcement of security should be taken together with the substantive case and judgement on both be given by the court. This is part of legal infrastructure facilitative of asset securitization.

5.9.2 Receiver's Exposure to Third Parties

The possibility of exposure by the receiver to third parties is another challenge of receivership. This is because receiver may be liable where in the purported exercise of his power interfered with the business of other persons other than those in respect of which he was appointed. In *Adetona v. Igele Enterprises Ltd*[579] the Supreme Court held that the provisions of section 393(1) of CAMA does not empower a receiver/manager to arbitrarily lock up the premises of other persons, other than the person over which he is appointed receiver/manager; or detain their properties in the purported exercise of his power. The court further held that where a receiver/manager in the exercise of his powers as such wrongly sells or detains goods of another entity which is not the subject of the receivership, the sale or detention of those properties amounts to conversion or detinue. In such cases, an action against the receiver and/or the debenture holder that appointed him will be held not to arise

[579] [2011] 7 NWLR (Pt. 1247) 535.

from the operations of CAMA such as to vest the Federal High Court with exclusive jurisdiction by virtue of section 251(1)(e) of the 1999 Constitution.[580]

In *Adetona v. Zenith International Bank Ltd*[581] the respondent a debenture holder brought an action for trespass against the appellant, a debenture holder and the appellant appointed by the appellant as a receiver in respect of the portion of the property of the debtor company mortgaged to the respondent. Augie, JCA held:

> "…the respondent's claims have nothing to do with the mortgaged property over which the 1st appellant was appointed as receiver; it has to do with the activities of the 1st appellant, which the respondent considers trespass against its own mortgaged property. The lower court was therefore right to hold that even though the dispute arose from the activities of the 1st appellant, if it relates to an action for trespass, which does not fall within the ambit of the said section 251(1)."

Also, as a trespasser, there is no leave required before an action is brought against for trespass.[582] The receiver/manager can on behalf of the company bring action or be sued yet the company does not lose its legal personality or its title to the goods in receivership[583]

5.9.3 Agency of Out of Court Appointed Receiver: Resolving the Conundrum

The decision of the Supreme Court in *Unibiz Nigeria Ltd. v. Commercial Bank Credit Lyonnais*[584] on the interpretation and application of section 390(1) of CAMA on the agency of a receiver appointed out of court has generated a debate as to the correctness of the decision in view of extant position under the common law and the wordings of section 390(1) of CAMA[585] which provides:

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580 Constitution of the Federal Republic of Nigeria (Promulgation Act) Cap C23 Laws of the Federation of Nigeria, 2010.
581 [2008] All FWLR (Pt. 440) 796.
582 *C.I.S.C. Plc. v. Tejumola Nig. Ltd* [2005] 29 WRN 41 at 62.
583 *Commercial Bank Credit Lyonnais Nig. Ltd v. Okoli* [2009] 5 NWLR (Pt. 1135) 446.
584 [2003]2 SC 22, [2003] 6 NWLR (Pt. 816) 402.
585 See: O Opasanya 'Who To Serve; God Or Mammon? Agency of Receiver/ Manager Appointed Out of Court' in O Ajayi (ed.), *Legal Aspects of Finance In Emerging Markets* (LexisNexis Butterworths, Durban, 2005) p 581.

> A receiver or manager of any property or undertaking of a company appointed out of court under a power contained in any instrument shall, subject to Section 393 of this Act, be deemed to be an agent of the person or persons on whose behalf he is appointed and if appointed manager of the whole or any part of the undertaking of a company he shall be deemed to stand in a fiduciary relationship to the company and observe the utmost good faith towards it in any transaction with it or on its behalf.

The facts in *Unibiz* case was that the Respondent lender, Commercial Bank Credit Lyonnais Ltd, instituted the action for itself and on behalf of the receiver, by way of *ex parte* Originating Summons before the Federal High Court. The fact deposed in support of the action was that the respondent was indebted to the appellant and despite repeated demands by the appellant and promises by the respondent, the appellant repeatedly defaulted even after a renegotiation after a frivolous litigation was instituted by the appellant consequent upon which the respondent appointed a receiver/manager and brought this action. The Federal High Court granted the following reliefs sought by the respondent: that the receiver is hereby directed to take such steps as may be necessary to realize the assets of the respondent with a view to paying its outstanding to the applicant bank; and that the respondent, its agent, privies and assigns including but not limited to its director, and officers is hereby restrained from doing anything that would prevent the receiver from performing his lawful duties as a receiver.

Being dissatisfied, with the decision of the Federal High Court, the Appellants appealed to the Court of Appeal and subsequently to the Supreme Court contending, inter alia, that the respondent debenture holder that has appointed a receiver/manager has no l*ocus standi* to institute the action. In resolving this issue against the appellant, the Supreme Court held that by virtue of section 390 (1) of CAMA, a receiver or manager of any property is deemed an agent of the person or persons on whose behalf he is appointed and that in that case it was not in dispute that the receiver was duly appointed by the respondent making reference to the instrument of appointment marked as Exhibit OF6.

Commenting on this case, Opasanya[586] appears to disagree with the decision of the Supreme Court as he contended that it would appear that counsel involved in the case did not adequately assist the court by marshalling all the authorities on the matter and expresses the hope that the authorities referred to by him in his comment will one day be useful to the court whenever the issue comes again for consideration.

The commentator having pointed out that the position at common law is that generally the receiver and manager will be deemed to be the agent of the debenture holder in the absence of contractual stipulations that the receiver/manager is appointed the agent of the company but that however, in practice there is usually such contractual stipulations in modern debenture, he submits that there is nothing in the provision of section 390(1) of CAMA which evinces any legislative intendment to change the common law position and that therefore it must be presumed that the common law still subsists.

Opasanya further submits that the phrase "… be deemed to be the agent of the person on whose behalf he is appointed…" implies that the question of whose agent a receiver is in Nigeria is not intended to be sacrosanct but rather a question of fact and therefore that the use of the word 'deem' does not derogate from the time honoured principles of upholding parties intention citing the decision in *Akeredolu v. Akinremi*[587] on the meaning of deemed. The

[586] O Opasanya (n 585).
[587] [1986] 2 NWLR (Pt. 24) 710.

commentator also submits that section 390(1) of CAMA does not raise any presumption against the debenture holder. Rather, it is a question of fact such that whenever the question arises as to who is the principal of a receiver between a chargee and a chargor, the court concerned would need to take evidence and critically examine the relevant underlying security document to come to a decision with a view to giving effect to agreement and intention of parties. To argue otherwise would presuppose that the legislature intended to make a receiver of the security holder willy-nilly.

According to the commentator, the mischief of the common law which section 390(1) of CAMA sought to correct was the fact that a receiver was not deemed to be an officer of the company and therefore left undisturbed the common law principle that receivers are deemed to be the agent of the company.

Alternatively, the commentator argued that assuming he was wrong on the view taken of section 390(1) CAMA, he contended that the provision did not legislate against contractual freedom of parties to fix the agency of a receiver as agent of the company. He therefore submitted that statutory agency contemplated by the provision of Section 390(1) CAMA should only arise in situations where parties fail to stipulate in their agreement whose agent a receiver is between a security holder and the borrower company as if the contrary intention is intended by the legislators they would have expressly provided against any contrary contractual stipulation as done in section 389(1) of CAMA. He further contended that Section 390(1) CAMA should be read subject to the provisions of section 393 CAMA and that section 393 will prevail where there is a conflict between the two provisions. To further buttress his submission, the commentator contended that it is inconceivable that a receiver would be made to stand in a fiduciary relationship with the company if it is not intended that the company is the principal of the receiver and that if there is no relationship between a receiver and the company, there would be nothing upon which to foist fiduciary duty stipulated in the second limb of section 390(1) CAMA.

As admirable as the contentions of Opasanya may seem, the present writer finds no merit in his submissions. Firstly, the decision of the Supreme Court in Unibiz both on law and on facts meets the justice of the case. Had the Supreme Court held that the receiver/manager was not the agent of the debenture holder in that case, the practical implication would have been to defeat the action brought to realize security against an apparently recalcitrant debtor. Secondly, the emphatic contention of Opasanya that having regard to the wordings of section 390(1) the determination of the agency of a receiver is a question of facts to wit: on whose behalf was the receiver/manager appointed, is supportive of the exact position taken by the Supreme Court in the case. According to Ejiwunmi JSC:

> "I think plain that the submission made for the respondent that a receiver or manager of any property is deemed by virtue of the provisions of section 390(1) of CAMA, an agent of the person or persons on whose behalf he is appointed. In the instant case, it is not in dispute that the receiver, a Mr. Babington Ashaye was duly appointed by the Commercial Bank Credit Lyonnias Nigeria Ltd."[588]

Thirdly, it would appear, however, that the emphatic proposition of Opasanya that the determination of whose agent is receiver is a question of fact is aimed at justifying his later contention that statutory agency contemplated by the provision of Section 390(1) CAMA should only arise in situations where parties fail to stipulate in their agreement whose agent a

[588] *Unibiz Nigeria Ltd. v. Commercial Bank Credit* [2003] 6 NWLR (Pt. 816) 402 at 424.

receiver is between a security holder and the borrower company and that a contrary intention would have been expressly provided against any contrary contractual stipulation. This contention is also not sustainable. A simple reading of section 390(1) would reveal that the only question of facts to be determined is: "on whose behalf was the receiver/manager appointed?" as was rightly done in the case of Unibiz. The attempt by Opasanya to read into the provision that the parties can negative this by contractual stipulation is not tenable. In fact, contrary to the submission of the commentator, the legislator would have expressly provided that the clear implication of the law may be excluded by parties' agreement as was done in the case of section 131(2) PCL[589] which stipulates thus:

> A Receiver appointed under the powers of this Law, or any enactment replaced by this Law, shall be deemed to be the agent of the mortgagor; and the mortgagor shall be solely responsible for the receiver's acts or defaults unless the mortgage deed otherwise provides.

Fourthly, the contention that it must be presumed that the common law still subsists because there is nothing in section 390(1) of CAMA which evinces any legislative intendment to change the common law position cannot stand in view of the express literal provisions of section 390(1). It is trite that where the language of legislation is plain, clear and not ambiguous, it must be given the literal interpretation and no presumption will arise in giving effect to same. In *Duru v. FRN*,[590] Mohammad JSC rightly put the position of the law thus:

> … whatever the words that make up a statute, be the statute substantive or advectival, the intendment of the law giver and the meaning of the statute is necessarily deciphered by assigning the clear and unambiguous words which make up the statute their ordinary literal meaning. …the duty of the court of law is limited to interpreting the law within the context of its constitutive words. It is not within the province of the court to seek the meaning of the statute outside the clear words the legislators employed.

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[589] See for example, Cap 132 Laws of Osun State, 2002.
[590] [2014] All FWLR (Pt. 712) 1677 at 1690.

Fifthly, the clear and plain language of section 390(1) of CAMA is not supportive of Opasanya's contention that the mischief of the common law which section 390(1) of CAMA sought to correct was the fact that a receiver was not deemed to be an officer of the company and therefore left undisturbed the common law principle that receivers are deemed to be the agent of the company. If at all that was the mischief intended, it has not been addressed by the unambiguous provision of section 390(1) of CAMA.

It is finally submitted that section 393 of CAMA is not supportive of the contention of the commentator. This is because the legislature has the power to make law to create fiduciary relation, even in the absence of any special relationship, such as required under the common law, between the company and the receiver.

In the subsequent decision of the Court of Appeal in *C.I.S.C. Plc. v. Tejumola Nig. Ltd*,[591] it was held that although the mode of appointment of a receiver may be different, the legal effect or incidence attached to that office is the same though the one appointed by the court is an agent of the court while the other is an agent of the debenture holder. It may thus be safe to assume that under the law as it is a receiver/manager will be held to be the agent of the debenture holder.

Be that as it may, the present writer agrees with Opasanya who correctly highlighted the possible adverse consequence of holding as a general rule that the receiver/manager shall be the agent of the secured lender and this adverse consequence may also negatively impact by necessary implication on asset securitization. According to the writer:

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591 [2005] 29 WRN 41 at 62 CA.

> …the appointment of receivers is a step taken by a lender at a time when its borrower is experiencing financial difficulties.
>
> It would therefore be imprudent to seek to increase the exposure of a secured lender to a non-performing customer whose failure made it imperative for the lender to seek assistance of a third party to recover its loan. This unfortunately would be the natural consequence of making the receiver the agent of the holder of security. If that were so, the security holder will be liable for the acts and omissions of the receiver. Similarly, the former will be liable for the fees and expenses of the latter. In my view, it is in order to minimize the exposure to a defaulting borrower that contractual security was devised; it is for the same reason that common law makes it impossible for the borrower to revoke the appointment of a receiver even though it regards the company as the principal of the receiver. Accordingly, anything that would exacerbate the risk of a secured lender would be antithetical.[592]

The present writer is of the view that rather than wait for a judicial reconsideration of the decision in Unibiz by the Supreme Court, an appropriate legislative reform of the law on agency of a receiver/manager is necessary. The certainty of the law in this regard will aid asset securitization.

5.10 Challenges of Enforcement of Security Interests by Foreclosure

Foreclosure is one of the means of enforcement of mortgages but it appears that this is rather an unpopular remedy resorted to by mortgagees in Nigeria going by near absence of reported cases on the remedy in Nigeria. It is observed that the procedure for foreclosure has not enjoyed full patronage by litigants in matters relating to secured credit.[593] While there is dearth of Nigerian authorities, it appears from English decisions that the legal provisions on foreclosure are rather recondite. Also, there are certain factors that make foreclosure an unattractive option in enforcement of security interests. These factors are particularly relevant in this discourse on asset securitization and enforcement of security interests.

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592 O Opasanya, (n 585) 586.

593 M Banire, A Basiru and K Adegoke, *The Blue Book 2013: Practical Approach to the High Court of Lagos State (Civil Procedure) Rules 2012* (3rd edn, Ecowatch Publications Nigeria Ltd, Lagos, 2013) 483.

An action for foreclosure is a judicial procedure by which the mortgagee acquires the mortgaged property for himself freed from the mortgagor's equity of redemption.[594] The legal and practical implication of a foreclosure order is to destroy and extinguish equity of redemption.[595] Considering that equity of redemption is a core principle in our law of mortgages which is jealously protected by the court,[596] foreclosure can only be obtained as a judicial remedy and the courts are wont to be reluctant in granting the remedy.[597]

5.10.1 Procedure for Foreclosure

By Order 51 rule 1 of the High Court of Lagos (Civil Procedure) Rules, 2013 (Lagos 2013 Rules) which is similar to Order 56 rules 6-7 of the High Court of Lagos (Civil Procedure) Rules, 1994[598] an action for foreclosure is initiated by an originating summons. Order 51 rule 1 of the Lagos 2013 Rules provides:

> Any mortgagee or mortgagor, whether legal or equitable, or any person entitled to or having property subject to a legal or equitable charge, or any person having the right to foreclose or redeem any mortgage, whether legal or equitable, may take out an originating summons, for such relief of the nature or kind following as may by the summons be specified, and as the circumstances of the case may require; that is
>
> (a) payment of moneys secured by the mortgage or charge;
>
> (b) sale;
>
> (c) foreclosure;
>
> (d) delivery of possession, whether before or after foreclosure, to the mortgagee or person entitled to the charge, by the mortgagor or person having the property subject to the charge, or by any other person in, or alleged to be in possession of the property;
>
> (e) redemption;

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594 I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 414.
595 See, *Re Farnol, Eades, Irvine and Co* [915] 1 Ch.D 22, 24; *Carter v. Wake* [1877] 4 Ch.D 605, 606.
596 See *Ejikeme v. Okonkwo* [1994] 8 NWLR (Pt. 362) 266 at 278.
597 J Omotola (n 211) 106.
598 M Banire, A Basiru and K Adegoke (n 593) 483

(f) reconveyance;

(g) delivery of possession by the mortgagee.

By Order 3 rule 8 of the High Court of Lagos (Civil Procedure) Rules 2013, the originating summons should be accompanied by; an affidavit setting out the facts relied upon; all the exhibits to be relied upon; a written address in support of the application; and Pre-action Protocol Form 01. Unlike in an action commenced by writ of summons where the defendant has 42 days to file his defence, a defendant in an action commenced by originating summons has 21 days to put in his counter-affidavit together with all the exhibits and a written address. It has been commented that the implication is that the procedure may support a simpler and more efficient determination of the rights of the parties where the amount outstanding can be easily ascertained thereby avoiding the rigorous process of leading evidence.[599]

In *Fasehun Motors Ltd v. UBA Ltd*,[600] the appellant had brought a preliminary objection that an action for enforcement of security ought to have been brought by a writ of summons and not originating summons. The Court of Appeal overruled the objection. According to Sanusi, JSC: "I think the wordings of this Rule are clear and ambiguous. It means that any mortgagee with right to foreclose a mortgage can commence action, by way of Originating Summons for sale or foreclosure of same."[601]

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[599] ibid
[600] [2000] 1 NWLR (Pt. 640) 191 at 199.
[601] supra at 199

This decision was however not considered in the subsequent case of *Ubah v. Fidelity Bank Plc*[602] where the Court of Appeal held that the action for foreclosure brought by originating summons was incompetent because there was dispute by parties as to the facts. The Court of Appeal held that that the affidavit in support of the originating summons and the Appellants' counter affidavit show a substantial divergence and disputes as to the instant case. Sankwa, JCA stated:

> In the present circumstances of this case, there is every cogent reason for me to believe, as rightly contended by the Appellants, that the lower court could not have made any specific findings of fact on the fundamentally vexed disputes of facts, without the need to call for oral evidence, thereby subjecting the forensic experts (that issued the reports) to rigorous and tortuous cross examination.
> Thus, there is no gainsaying the fact, that the originating summons procedure was not the appropriate and most convenient procedure that ought to have been adopted in commencing the instant action. This view is predicated upon the simple, albeit rather obvious, reason that the facts in dispute, as contained in the parties' respective processes, could not have been conveniently resolved without resorting to oral evidence.[603]

With respect, this decision of the Court of Appeal has created uncertainty to the appropriate procedure for commencing an action for foreclosure. The Court of Appeal rather than consider and hold that Order 51 of Lagos State High Court Civil Procedure Rules 2004 is a specific express provision that authorized the commencement of action for foreclosure decided to have recourse to the general rule on use of originating summons when the Court held:

> Instructively, the principle has cherishingly been settled, that the originating summons procedure should be resorted to only where it is so obvious that the main question in issue is likely to be for construction of a written law, or of any instrument made under a written law, or deed, will, contract or other document, or some other question of law. Secondly, the originating summons procedure may equally be resorted to, where there is likely not to be any substantial dispute of fact. See PDP VS. ABUBAKAR (2007) 3 NWLR (Pt. 1022) 515 @ 544 -545

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[602] (2013) LPELR-20658 (CA)
[603] *Ubah v. Fidelity Bank Plc*, supra.

It is submitted that Order 51 of the 2004 and 2013 Lagos Rules is a specific provision which the court ought to have held to be applicable rather than resort to the general rule on the use of originating summons as it is a cardinal rule of interpretation that a general provision does not diminish the force of a special provision - *generalia specialibus non derogat*.[604] Also, the fact that there are or there may be dispute as to facts should not necessarily make the use of originating summons inapplicable. It is recognized position of law that even where originating summons is utilized as specified in the rule, there may be need to still call oral evidence where conflicting facts are deposed in the affidavits which cannot be resolved by the documents attached to the affidavit in support and the counter affidavit.[605]

An innovative provision in section 116, Evidence Act, 2011 legislated the existing judicial position when it provides:

> When there are before a court affidavits that are irreconcilably in conflicts on crucial facts, the court shall for the purpose of resolving the conflicts arising from the affidavit evidence, ask the parties to proffer oral evidence as to such facts, and shall hear any such oral evidence of the deponents of the affidavits and such other witnesses as may be called by the parties.[606]

Therefore, where an action for foreclosure is brought by originating summons and there is dispute as to facts which cannot be resolved by attached documentary evidence, the court ought to call oral evidence to resolve the dispute rather than hold that the action brought pursuant to a specific order of court is incompetent. It is submitted that on the facts of the case of *Ubah v. Fidelity Bank Plc*,[607] rather than holding the action incompetent because it was brought by way of Originating Summons, the Court of Appeal ought to have held that the trial

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[604] *Unongo v. Aku* (1983) LPELR-3422 (SC).

[605] See *Bisimillahi v. Yagba-East Local Government* [2003] FWLR (Pt. 141) 1939; *Madagi v. NPC* [1998] 11 NWLR (Pt. 572) 66.

[606] See S T Hon *Law of Evidence in Nigeria*, Vol. II (2nd edn, Pearl Publishers, Port Harcourt, 2013) 1103 for instances where oral evidence need not be called notwithstanding the provisions of section 116 of the Evidence Act.

[607] (2013) LPELR-20658 (CA).

court erred by not calling evidence to resolve the conflicting facts in the affidavits of the parties. It is further submitted that the practical effect of the decision is to emasculate if not render otiose Order 51 of the Lagos Rules. Furthermore, there is no way a claimant can predict, *ex ante*, at all times that there will be conflicting deposition of facts.

5.10.2 Proper Claimants for Order of Foreclosure

The remedy of foreclosure is generally available to legal mortgagees, it is, however, only available to an equitable mortgagee where the equitable mortgage is created by deposit of title deed accompanied by an agreement by the borrower to give a legal mortgage if required to do so. Therefore, an equitable chargee cannot foreclose.[608] In *Ogundiani v. Araba,*[609] Idigbe JSC stated:

> … where the mortgage is by way of charge, and not by conveyance, the mortgagee takes no estate whatsoever in the land or in the property but he has generally only an equitable interest to be enforced by sale upon an order of court. The equitable charge simpliciter only gives a right to payment out of the property; it does not amount to an agreement to give a legal mortgage at all. The strict mode of enforcing the charge is, however, by sale (or appointment of a receiver under an order of court) but never by foreclosure. On the other hand where, as here, the agreement is to create a legal mortgage when required following a default in the terms of the agreement, the agreement may be enforced according to its terms notwithstanding that the legal mortgage when executed will also confer on the mortgagee an immediate power of sale (Hermann Vs Hodges (1873) L.R. 16 E. 18). The equitable mortgage by agreement to create a legal mortgage, therefore, entitles the equitable mortgagee to something more than a mere right to payment out of the property or premises mortgaged; under the general principles, his remedies correspond as nearly as possible with those of the legal mortgagee.

It should be noted that the right to foreclose arises after the date for legal redemption because it was then that the equitable right to redeem arises; "until then there is nothing to extinguish by foreclosure."[610] Determining when the date of legal redemption has passed may in certain cases not yield for easy determination. However, as a matter of law, a mortgagee's power of

[608] Fisher and Lightwood (n 492) 729.
[609] [1978] Vol. 11 NSCC 334 at 345.
[610] Fisher and Lightwood (n 492) 726.

sale or foreclosure cannot be affected merely because the amount due under the mortgage agreement is in dispute.[611] It is also imperative that the claimant must join those interested in the security and those interested in the equity of redemption as parties.[612]

5.10.3 Order of Foreclosure

The order of foreclosure is granted in two stages; order of foreclosure nisi and order of foreclosure absolute. The foreclosure order nisi will provide for the mortgagor to be foreclosed if he fails to pay the required sum at the time appointed by the order. If the mortgagor fails to pay the amount found to be due at the specified time and place, the mortgagee is entitled to have the order of foreclosure in the original order made as a matter of course.[613]

5.10.4 Order of Judicial sale in Lieu of Foreclosure

The order of foreclosure is not granted as a matter of course and as such the court may direct a sale, known as "judicial sale" rather than making order of foreclosure. Judicial sale is ordered usually where the value of the property exceeds the amount claimed. This may be because the court is not disposed to allowing the mortgagee to make unearned profit. Judicial sale is also ordered where there are successive mortgagors such that the mortgagor or subsequent mortgagees should have the opportunity of obtaining the surplus that may be realized upon a sale. According to Omotola,[614]

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[611] See *AIB Ltd v. Lee Ind. Ltd* [2003] 7 NWLR (Pt. 819) 366; *Omidiji v. F.M.B.* (2001) 13 NWLR (Pt. 731) 646.
[612] See, Fisher and Lightwood (n 492) 730-736 for those that come within the categories.
[613] Fisher and Lightwood (n 492) 751. See also I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 415.
[614] J Omotola (n 211) 106.

> … our courts are more inclined to order a sale instead of foreclosure even where it is apparent that the situation has arisen for the order. Perhaps the reasoning of the court is to prevent unjust enrichment on the part of the mortgagee who may have received part of the debt or whose loan is less than the value of the mortgaged property.

5.10.5 Challenges of Foreclosure

Foreclosure is now rarely sought or granted. A reason for this is that majority of mortgages are now made by institutional lenders. Therefore, the institutional lenders will not normally seek to have the property vested in itself. Rather they will seek for an order of possession so that they can sell with vacant possession under their power of sale or appointment of receiver.[615] It is submitted that it is doubtful whether foreclosure will be of utility in aid of security interests underlying an asset securitization transaction.

Another challenge of enforcement of security interests by foreclosure is the uncertainty surrounding the circumstances that the court may reopen foreclosure and redeem the equity of redemption coupled with the position that foreclosure may be re-opened against one who has purchased the estate from the mortgagee. Generally, the reopening may be ordered where the mortgagee, after obtaining order absolute, proceeds on the personal covenant.[616] It has also been held that the court has discretion to re-open a foreclosure if such relief appears in the special circumstances of the case to be due to the mortgagor. In this regard, Smith has commented that it is impossible to lay down a general rule as to when relief of reopening of

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[615] Fisher and Lightwood (n 492) 725.
[616] *Perry v. Barker* (1806) 32 E.R. 459.

foreclosure will be granted as everything may depend on the particular circumstances of each case.[617] There is thus lack of finality in an order for foreclosure.[618]

Foreclosure requires a court order of the court; it is not a self-help remedy.[619] According to Fisher and Lightwood:

> In bringing a claim for a foreclosure, the mortgagee asks the court for the equity of redemption of the mortgagor and all the persons claiming through him to be extinguished, and for the mortgaged property to be vested absolutely in the mortgagee. If that relief is granted, the mortgage is said to be foreclosed. The mortgagee thereupon becomes the absolute owner of the property in both law and equity (subject only to the court's discretion to 'reopen' the foreclosure at a later date).

This necessity of recourse to court is another challenge of foreclosure in view of the delay in and cost of litigation. It has thus been rightly commented that a claim for foreclosure will inevitably involve greater expense and uncertainty than the exercise of a mortgagee's remedy out of court.[620] In addition, the procedure for foreclosure as well as the recondite and complex nature of the remedy makes the remedy unattractive.

Another drawback to the utility of foreclosure is that it may be caught by the rule of *lis pendes*. In *De-Jesse Nigeria Limited v. Wema Securities & Finance Plc*,[621] it was held that a sale of property during the pendency of a suit challenging order of foreclosure will be caught by the rule of *lis pendens* which is to the effect that the doctrine of *lis pendens* is a strict one which operates to prevent the effective transfer of any property in dispute during the pendency of the dispute. It is insignificant, irrelevant, and immaterial whether the purchaser

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617 I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 416.
618 Fisher and Lightwood (n 492) 725.
619 *Re Farnol, Eades, Irvine & Co* [1915] I Ch.D 22 at 24.
620 Fisher and Lightwood (n 492) 725.
621 (2013) LPELR-20076 (CA).

had notice, actual or constructive. *Lis pendens* applies to title of a property and when such title is the subject matter of litigation, all intending sales must abate, pending the outcome of the litigation.[622]

Aside, the foregoing there is also the issue of consent to land-based transaction. It is to be noted that applicability of the requirement of consent under the LUA where foreclosure has been granted would depend on whether the mortgage is legal or equitable and in case of legal mortgage, which part of Nigeria the mortgage transaction took place.[623] According to Smith, an order of foreclosure in the case of equitable mortgage enlarges the estate of the equitable mortgagee and vests the mortgagor's legal estate absolutely in the mortgagee. Therefore, the process is ineffectual unless consent is sought and obtained because it involves a transfer of the legal estate from the mortgagor to the mortgagee. He further submits that Governor's consent must also be sought and obtained in the case of foreclosure of a legal mortgage created in the old Western and Midwestern States[624] where mortgages are created by demise, sub-demise, or by charge with the effect that an order of foreclosure operates to vest the property in the mortgagee absolutely which was not previously vested in him. In the case of a legal mortgage created in Eastern and Northern States of Nigeria, he submits that consent is not required because there is no transfer in any form as the legal mortgage already conveyed a legal estate to the mortgagee subject to cesser on redemption by the mortgagor.[625]

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[622] See *Osagie v. Oyeyinka* (1987) 2 NSCC 840 at 849, *Barclays Bank of Nigeria Ltd. v. Ashiru* [1978] 6 SC 99 page 190 paras D-F.

[623] I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 417.

[624] That is, Oyo, Ogun, Ondo, Ekiti, Osun, Edo and Delta States.

[625] I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 417- 418.

The foregoing challenges and drawbacks of foreclosure makes it unattractive and of limited utility in the context of enforcement of security interests in aid of asset securitization. In fact, in England, the Law Commission has recommended the abolition of foreclosure. In the Republic of Ireland, foreclosure has been replaced by judicial sale and in New Zealand foreclosure has been abolished. In Canada foreclosure, even though an available remedy, lending institutions prefer to exercise power of sale out of court.[626]

5.11 Enforcement of Security Interests as a Legal Risk to Asset Securitization

Legal risks and its challenges to asset securitization is the preoccupation of Chapter Seven of this work but it is considered apposite to discuss here the legal risks of the underlying security interests which may manifest in the context of enforcement of the security interest.

In Nigeria, enforcement of security interests is susceptible to many difficulties such that even self-help remedies such as sale of the mortgaged properties are often times subject matter of long drawn litigations on puerile legal grounds concocted by debtors to avoid enforcement and realization of the security.

An example of such is *Owoniboys Tech v. Union Bank of Nigeria*[627] In that case, it was argued on behalf of the mortgagor that because of the subsequent mortgages consequent upon further credit there has been a merger of mortgages. In which case, the subsequent mortgage of the same property supersedes the earlier mortgage and that the earlier mortgage having merged in the subsequent mortgages and no consent was obtained to them then the mortgages

[626] Fisher and Lightwood (n 492) 725.
[627] (2003) 40 WRN 1.

are null and void for failure to obtain governor's consent in breach of section 22 of the LUA and section 27 of the Land Tenure Law and that the earlier mortgage is not enforceable having merged with subsequent invalid mortgages. Thus, even though the mortgagee had defaulted in payment of the mortgaged sum, the contrived issue now raised to avoid enforcement by the mortgage which already had governor's consent was that the consent of the governor is required again following an increase in the amount of credit advanced to the same borrower upon the same mortgage.

This case has to drag up to the Supreme Court. Thankfully, the Supreme Court was able to see through the contrivance and held that there was no question of merger of mortgages operating because all the said deed of mortgage are security of the same nature in legal valuation.[628] They are concerned with the property which, by the governor's consent, has been permitted to be used as collateral for a loan transaction. According to Uwaifo JSC:

> The Governor's consent has indicated on Exhibit 4 has nothing to do with the amount of loan; the consent is for the alienation of the legal title in the property to the respondent (the mortgagee)…, for the period of the mortgage transaction. So no further consent was necessary just because further loans had been obtained upon the same collateral.[629]

It is submitted that this decision is commendable as being practical and furthering the need of commerce and credit transaction. To have decided otherwise would not only have worked injustice on the lender in the case but would have created rigidity and complexity in the way of credit restructuring, renegotiation and timely and cost-effective access to credit by borrowers.

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[628] The court also held that an intention to create a merger of mortgages must be evinced by evidence and from the documents executed by the parties - (2003) 40 WRN 1, 21 (Ejiwunmi JSC).

[629] [2003] 15 NWLR (Pt. 844) 545; (2003) 40 WRN 1, 31. His Lordship further noted: "The consent of the governor for the mortgage transaction covers all the needs of mortgage. Those deeds are in respect of one transaction, namely mortgage to secure money lending although the lending came to involve first advance and further advances. It does not matter whether the governor's consent came before or after negotiation for the lending was concluded; ibid at 32.

5.12 Problem of Delay in Enforcement of Security Interests

The history of the case of *Owoniboys Tech v. Union Bank of Nigeria*[630] provides a good illustration of the problem of enforcement of security interests in terms of the length of the adjudicatory process. The matter was eventually decided by the Supreme Court on 11th July, 2003.[631] So, on the whole, the matter took a period of about fifteen years before final determination of the secured creditor by the Supreme Court! Even as the facts of the case of *Akano v. F.B.N. Plc.*,[632] showed, a buyer of a mortgaged property has to litigate for about five years after purchase before judgment at the Court of Appeal.

One of the ways by which there is delay in enforcement of security interests is through needless interlocutory appeals. In *Azuh v. Union Bank of Nigeria Ltd,*[633] Kekere-Ekun JSC, observed as regards the effect of needless interlocutory appeals:

> It is most unfortunate that because of the pendency of the appeals to the lower court and to this court, an ex parte order of interim injunction, meant to last for just a few days, has remained in place for 13 years, when an application pursuant to Order 8 rule 11 of the High Court (Civil Procedure) Rules, which provides that an application to set aside the order may be brought within 7 days of the order, would have disposed of the matter a long time ago.

It is submitted that one of the areas of reform is that there should be limitation and/or on the exercise of right of interlocutory appeal in secured credit cases. For instance, there may be stipulation for deposit of the judgment debt in an interest yielding account as a condition precedent for exercise of interlocutory appeal.

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[630] [2003] 15 NWLR (Pt. 844) 545; (2003) 40 WRN 1.
[631] See the history of the case in *Owoniboys Tech v. Union Bank of Nigeria* [2003] 15 NWLR (Pt. 844) 545 at 570-571.
[632] [2004] 8 NWLR (Pt.875) 318.
[633] [2014] 11 NWLR (Pt. 1419) 580 at 661.

5.13 Enforcement of Security and Self-Help

Umezulike[634] has pointed out that, in recent times, some mortgagees have resorted to self-help as a means of realizing security. They resort to these having been exasperated by the long drawn legal battles to realize their security and faced with financial distresses because of failure of the mortgagors to liquidate the mortgage debt.[635] For instance, the mortgagees forcibly intercept the mortgagors on the highways or enter the mortgagors' premises to distrain goods, chattels, car and cash to realize the mortgage debt.[636] This development on resort to self-help, which is a manifestation of the crisis of enforcement of security interest in Nigeria, has also been subject of some judicial decisions.[637]

For instance, in *Union Bank of Nigeria Plc v. Ajabule* [638] the Respondent failed to repay the credit facilities granted by the Appellant in spite of repeated demands, the Appellant then took steps to enforce its rights under the Deed of Hypothecation of the Stock of Motor Batteries in the custody of the Respondent. When the Respondent refused to allow the Appellant to take over the control and management of the Respondents' business premises, the Appellant proceeded by force and sealed the premises which the Respondents challenged by their action at the trial Court on 11th August, 1999. In confirming the award of general damages, Mohammed JSC stated:

> It is certainly undisputed from these paragraphs of the statement of claim that the Respondents' claim for general damages arose directly from the conduct of the Appellant in unconstitutionally and illegally sealing the 2nd Respondent's premises which subjected the Respondents to public ridicule and odium resulting in greatly damaging the reputation of the

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[634] I A Umezulike, *ABC of Contemporary Land Law in Nigeria* (n 467) 325.
[635] ibid
[636] ibid, 325.
[637] See, *Union Bank of Nigeria Plc v. Ajabule* (2011) LPELR-8239 (SC); *Shining Star Nigeria Ltd v. AKS Steel Nigeria Ltd* (2011) LPELR-3053 (SC); and *FBN v. Akpan* (2011) LPELR-4163 (CA).
[638] (2011) LPELR-8239 (SC) 1.

> Respondents in general and subjecting the 1st Respondent to humiliation and embarrassment in the hands of the Police in the course of investigating the petition or complaint of the Appellant against the Respondents to the police. Having regard to the decision of this Court in Chief Ojukwu v. Governor of Lagos state (1986) 1 N.W.L.R. (Pt. 18) 62 in which this court condemned in strong terms that self help has no place in our civilized world as it is against the observance of the Rule of Law in a democratic set up like ours, certainly, the Respondent's claim for general damages in the present case is quite in order as found by the court below.[639]

5.14 Enforcement of Mortgage under the Lagos State Mortgage and Property Law

The Lagos State Mortgage and Property Law 2012 (LSMP Law) is perhaps the most recent property legislation impacting on security interest, in particular mortgage. By section 68 of the LSMP Law, the commencement date of the law is provided to be 23rd day of August 2010. However, it would seem that the law has retroactive effect in many respects. For instance Section 19(6) of the LSMP Law provided that the provision of section 19 on realization of right of occupancy applies to "a mortgage whether created before or after the commencement of this Law, and to a mortgage term created by this Law". Also, sections 20(6) section 21(2) section 22(5) section 29(5) section 30(5) respectively makes the provisions of the law in section 20 on realization of leasehold mortgages, section 21 on realization of equitable charges by the court, section 22 on sale of mortgaged property in an action for redemption or foreclosure, section 29 on tacking of further advances and section 30 on obligation to transfer instead of recovering and right to take possession applicable to mortgages of land made before or after the commencement of the law. Further, section 44(3) which makes section 44 on effect of advance payment on joint account applicable to "any mortgage or transfer made after the thirtieth day of June, two thousand and ten (30th June, 2010)" and section 45(2) makes provision in section 45 on notice of trust affecting mortgage debts applicable to "mortgages made before or after the commencement of this Law"

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[639] (2011) LPELR-8239 (SC) 1 at 28.

It is submitted that the practical implication of the above provisions is to introduce legal incidence to mortgages not contemplated by the parties at the time they entered into mortgage transactions made before the commencement of the law. The policy justification for retroactive application of the above sections to mortgages made before the law is unclear.

Another issue that may arise under the law is the status of Conveyancing Act 1881 under the law. The side note to section 68 of the LSMP law is couched "Repeal" and the actual provision is the "provisions of the Conveyancing Act shall not have any application and effect on mortgage transactions under this law. The obvious literal meaning of the provision is to exclude the application of the Conveyancing Act 1881 to mortgage transactions under the law. There is no intendment to repeal the Conveyancing Act. It is even debatable whether the legislature in Lagos can repeal the Act. The best that can be done by them is to expressly exclude its application. Therefore, the side note to section 68 of the LSMP law is misleading and confusing and should be ignored in applying the provision.[640]

5.14.1 Modes of Enforcement of Mortgage Security under LSMP Law

The traditional modes of enforcement of mortgage, that is, enforcement of covenant to pay, entering into possession, sale of mortgaged property, appointment of receiver and foreclosure of equity of redemption[641] were retained by the LSMP law. The provisions of the LSMP law on these modes of enforcement will be discussed hereafter.

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[640] *Orji v. FRN* [2007] All FWLR (Pt. 385) 462 at 482, Salami JCA stated that the words in a statute are clear and unequivocal, it is unnecessary to seek aid from within the statute itself such as footnote.

[641] I O Smith, *Practical Approach to Law of Real Property in Nigeria* (n 471) 394-395.

5.14.1.1 Enforcement of Covenant to Repay under the LSMP Law

The LSMP law provides for three circumstances whereby a mortgagee has a right to sue for mortgage money.[642] First is where the mortgagor binds himself to repay the same. Whether the mortgagor so binds himself to pay will be a function of interpretation and application of the mortgage contract.[643] The practical effect of this provision in structuring asset securitization is that appropriate due diligence would have to be undertaken that there is a provision in the security underlying the secured assets that binds the mortgagor to repay.

Second is where either the property is wholly or partly destroyed or the security is rendered insufficient.[644] However, before a mortgagee can exercise the right to sue for mortgage money under either of these two situations, the mortgagee is required to give the mortgagor a reasonable opportunity of providing further security enough to render the whole security sufficient and the mortgagor has failed to do so. In an action for repayment brought under either of these situations, it is imperative for the mortgagee to plead the circumstances stipulated in section 23(b) otherwise, the action may be defeated as disclosing no cause or reasonable cause of action.[645] Conversely, a defendant mortgagor intending to challenge that the circumstances for exercising the right to recover mortgage money under section 23(b) has not arisen must plead same specifically as a condition precedent[646] and/or under Order 15 rule 7 of the High Court of Lagos State (Civil Procedure) Rules 2013 which provides that all grounds of defence or reply which makes an action not maintainable or if not raised will take

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[642] Section 23 of the LSMP Law.
[643] Section 23(a) of the LSMP Law.
[644] Section 23(b) of the LSMP Law.
[645] See M Banire, A Basiru and K Adegoke (n 593) 198 - 203 on failure to disclose cause of action or reasonable cause of action.
[646] See Order 15 rule 6 of the High Court of Lagos State (Civil Procedure) Rules 2013.

the opposite party by surprise or will raise issues of facts not arising out of the preceding pleadings shall be specifically pleaded. The present writer is of the view that the inclusion of the phrase “or reply” in Order 15 rule 7 is difficult to comprehend because it is difficult to envisage how a ground of reply will make an action not maintainable as a reply is like a rejoinder to the defence in an action. While it may be safe to assume that what is intended is that all grounds of defence which makes an action not maintainable shall be specifically pleaded, it is suggested that the provision requires some amendment to make the provision lucid.[647]

Third, an action to recover mortgage money may be brought where the mortgagee is deprived of the whole or part of his security by or in consequence of the wrongful act or default of the mortgagor.[648] For instance where the right of occupancy in respect of the mortgaged property is revoked under the LUA[649]

5.14.1.2 Sale of Mortgaged Property under LSMP Law

Section 37 of the LSMP on the regulation of exercise of power of sale is substantially similar to section 20 of the Conveyancing and Law of Property Act, 1881[650] with two major differences. First is that the period of default after the service of the written notice for the payment of the mortgage money, interest on it or of part of it is now two months. Secondly, for both payment of mortgage money and interest thereon, notice of requiring payment of the mortgage money must be served on the mortgagor or one of two or more mortgagors.

647 This position was expressed by this writer in conjunction with two other writers in M Banire, A Basiru and K Adegoke (n 593) 192 - 193.
648 Section 23(b) of the LSMB Law.
649 Cap L5 Laws of the Federation of Nigeria, 2010.
650 44 & 45 Vict. Ch.D 41.

Therefore, the provision of section 20(ii) of Conveyancing and Law of Property Act, 1881[651] which dispensed with notice where some interest under the mortgage money is in arrears for two months after becoming due is no longer the law.

Section 40(1) to (4) of the LSMP Law which provides for exercise of power of sale is also substantially similar to section 21(4) to 21(7) of the Conveyancing and Law of Property Act, 1881.[652] The only difference between these provisions is the addition of the provision in section 40(3) of the LSMP Law that the mortgage shall not be answerable for any involuntary loss happening in or about the exercise or execution of any power or provision contained in the mortgage deed where the mortgage is executed after the commencement of the Law. This additional provision is not in the Conveyancing and Law of Property Act, 1881.[653]

In view of the foregoing, it is submitted that the LSMP Law has not effected substantial amendment of the law regulating exercise of power of sale in mortgage transactions.

5.14.1.3 Appointment of Receiver under the LSMP Law

Section 43 of the LSMP is essentially the same as section 24 of Conveyancing and Law of Property Act, 1881.[654] The slight variation concerned insertion of the phrases "and to exercise any powers which may have been delegated to him by the mortgagee in accordance with this Law" and 'in or towards discharge of the principal money if so directed in writing by the mortgagee" respectively section 43(8)(3) and section 43(8)(e) of the LSMP Law. Therefore, essentially, the LSMP Law has not effected reform of the law in this regard and the position

[651] ibid.
[652] ibid.
[653] ibid.
[654] ibid.

under the Conveyancing and Law of Property Act, 1881[655] as reenacted under the LSMP still remain the law.

5.14.1.4 Foreclosure of Equity of Redemption under the LSMP Law

Except for bare reference to foreclosure in some sections like sections 19 and 20, the LSMP Law did not address foreclosure which issue, as discussed above, is recondite. Otubu rightly put the position correctly when he commented that rather than coming out clearly to statutorily define the ambits and procedure for foreclosure rights, the law leaves the parties "to wallow under the undulating judicial position on the matter of foreclosure".[656] It is submitted that failure of the LSMP Law to address the foreclosure issue, either to retain it and streamline the legal position and procedure, or to totally abolish it as it has been done in some jurisdiction is a major drawback of the LSMP Law.

5.14.2 Appraisal of Enforcement of Mortgage under the LSMP Law

Enforcement of mortgage security in Lagos State will have to contend with the provision of section 64 of the Law that any contract of mortgage that does not comply with the provisions of the law shall not be enforced in a court of law. There is, therefore, the possibility of a challenge to an action on enforcement of mortgage security on the grounds of non-compliance with certain specific provisions of the LSMP Law such as; section 53 on filing of mortgage instrument with the Executive Secretary of the Lagos State Mortgage Board, section 54 on protection of mortgagors from unconscionable practices, section 55 on estimate of charges, section 56 on regulation of mortgage promotion, section 57 on payment into escrow accounts,

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655 ibid.

656 A Otubu 'National Housing Policy and the Mortgage and Property Law Lagos State 2010' available at http://ssrn.com/abstract=2536129 last visited on May 18, 2015.

section 58 on prohibition against kickbacks and unearned fees, section 59 on prohibition of collateral contracts, section 60 on prohibition against negative amortization, section 61 on financing of insurance or other products sold in connection with the loan, section 62 on fees for preparation and submission of loan application for borrowers.

The issue of non-compliance with the provision of the law as a bar to enforcement of mortgage security under the law is a matter of substantive law and must be taken together with the substantive issue not as a threshold issue which may be taken by way of preliminary objection and taken together. Further, a party relying on section 64 of the Law as a bar to enforcement of mortgage must specifically plead and prove non-compliance. This submission is by virtue of Order 15 rule 7(1) and (2) of the High Court of Lagos State Civil Procedure Rules, 2012 which provides:

> "(1) All grounds of defence or reply which makes an action not maintainable or if not raised will take the opposite party by surprise or will raise issues of facts not arising out of the preceding pleadings shall be specifically pleaded.
> (2) Where a party raises any ground which makes a transaction void or voidable or such matters as fraud, Limitation Law, release, payment, performance, facts showing insufficiency in contract or illegality either by any enactment or by common law, he shall specifically plead same".

Having pleaded facts to defeat enforcement of the mortgage, the party contesting the enforcement must also prove same. In *Victor v. F.U.T.A.*,[657] the Supreme Court held that pleadings do not constitute or substitute for evidence. In the absence of evidence in support of pleading, the pleading will be deemed as abandoned.[658]

[657] [2015] 4 NWLR (Pt. 1448) 1 at 56.
[658] See *Olowoofoyeku v. Olowoofoyeku* [2011] 1 NWLR (Pt. 1227) 177; *S.A.F.P. & U v. U.B.A. Plc* [2010] 17 NWLR (Pt. 1221) 192 SC. See *Nsionu v. Nsionu* [2011] 16 NWLR (Pt. 1274) 536 at 547 G-H on abandonment of pleading. See also M Banire, A Basiru and K Adegoke (n 593) 203.

It is noted that one of the grounds that may be called in aid to render a mortgage security unenforceable by virtue of section 64 of the LSMP Law is provided in section 53 of the LSMP law which provides that a mortgage institution shall file one copy of any instrument evidencing a mortgage transaction at the Office of the Executive Secretary of the Board. The present writer agrees with the position of Otubu[659] that the provision is "tantamount to excessive bureaucracy and red-tapism in the mortgage administration". According to the commentator:

> "Of what impact is the filing of the instrument when same must have been registered at lands registry, does it impact on priority of charges and what is the penalty for failure to file same? The law can do without this provision before it is turned into another revenue generation scheme by the state."

In addition, and from the point of view of asset securitization, the provision of section 53 of the LSMP Law making a mortgage security unenforceable for failure to register the mortgage instrument increases the due diligence requirements in structuring the transaction and as well introduces additional legal risk for asset securitization.

Notwithstanding some of the highlighted drawbacks of the LSMP Law, there are provisions in the Law useful to expeditious and judicious determination of disputes around enforcement of mortgage security which will positively impact on structuring asset securitization. One of such provisions is targeted at addressing the abuse of application for and grant of interlocutory injunction. Section 26 of the LSMP Law provides that in granting an application for injunction to restrain the exercise of any of the rights or powers conferred by the Law on a mortgagee, a Court shall require the mortgagor as a condition precedent to deposit any outstanding unpaid balance of the principal loan sum under mortgage transactions as at the

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[659] A Otubu (n 656).

date of the grant of the order of injunction into an interest yielding account in the name of the Registrar of the High Court. An identifiable pitfall of this provision is that genuine applicants for interlocutory injunction who are financially challenged would be denied of the opportunity to benefit from the injunctive relief.

Section 24 of the LSMP Law also provides for expeditious determination of cases under the law. Also for equitable and realistic enforcement of mortgages by the mortgagors and mortgages, the law allows sale in a proceeding by the mortgagor or mortgagee by section 22 of the Law. A very robust provision of utility in action for enforcement of mortgages is section 25 of the LSMP Law. The section provides that a court must take into consideration the following items before giving any order: (a) The prevailing interest rates for mortgage lending; (b) The general availability of housing or lack of it; (c) The comparative ability of either party to give monetary compensation; (d) A party who is found by the Court to have deliberately delayed any of proceedings to enforce a mortgage transaction under this Law shall be liable to pay costs, additional cost and expenses incurred by the other party by reason of such delay; (e) A party who declined a genuine offer to settle and failed to do better at judgment shall pay any or all cost incurred by the party who offered after the date of offer. It is submitted that the combined effect of sections 25(e) and 26 and if adhered to by the court will assist in stemming the tide of frivolous prosecution of enforcement action and delay in judicial process. It is further submitted that there is much to commend in the LSMP Law to other jurisdictions in Nigeria.

5.15 Summary

This chapter examines challenges of enforcement of security interests against the background of the finding that difficulty in enforcement of security will negatively impact success of asset securitization. The study finds that distinctions between legal mortgage and equitable mortgage have legal implications in the context of enforcement of the security. Also, that the distinction between a fixed and floating charge is significant in the event of a borrower's insolvency. The study finds that because of the nature and legal incidents, pledge and lien lack utility in asset securitization. Therefore, of the four kinds of security interests, only mortgages and charges were considered in the chapter.

The study finds that aside the claim for the recovery of debt, a mortgagee may enforce the security by entering into possession, sale of mortgaged property, appointment of receiver and foreclosure of equity of redemption. The methods of enforcement are cumulative and not exclusive. The study also finds that the form of mortgage will determine the mode of enforcement.

While the study finds that one of the attractions of legal mortgage is the power of the mortgagee to enforce the security by sale outside court, in practice the exercise of this power is at times subject matter of protracted litigation and underscore one of the challenges of enforcement of security interests in the context of asset securitization.

The study finds that the court will not enforce a claim where the interest rate is considered excessive, usurious and therefore illegal as well as where it contravened the applicable interest rate allowed by the Central Bank of Nigeria at the time of the contract.

The study finds that one of the challenges of enforcement of security interests is the propensity of mortgagors to contest the exercise of the power of sale, at times on frivolous grounds to frustrate the realisation of the security. The study submits that there is good policy sense in the court exercising caution in refusing to give effect to secured transactions, particularly mortgages.

The study also finds that improper use of injunctive reliefs, particularly interim and interlocutory injunctions is another challenge of enforcement of security interests in Nigeria. Further, the requirement of consent under the Land Use Act is a serious hindrance to land based security interests. The study finds that the consent requirement translates to additional due diligence requirements for secured lenders as well as professionals engaged to structure asset securitization with the implication of making asset securitization unattractive. This study therefore suggests that secured transactions should be excluded from the consent provisions under the LUA.

The study finds that one of the drawbacks of enforcement of security interests is that even in situations where the enforcement remedy can ordinarily be carried out as a self-help remedy without recourse to court, as for instance appointment of receiver/manager under Debenture Trust Deed, lenders and/or their agents still have to go to court for assistance. The study submits that the practical effect of this is further exposure to cost of litigation as well as unnecessary delay in realizing the security.

The study also considered the use of preliminary objection to frustrate enforcement of security and the possibility of its abuse to frustrate enforcement action. Therefore, the present writer suggests that there should be specific provisions in the law that preliminary objections in actions for enforcement of security should be taken together with the substantive case and judgement on both be given by the court.

While submitting that the possibility of exposure by the receiver to third parties is another challenge of receivership, this work critically appraised the view of Opasanya on agency of receivership. The present writer submits that rather than wait for a judicial reconsideration of the decision in *Unibiz* by the Supreme Court, an appropriate legislative reform of the law on agency of a receiver/manager is necessary and that the certainty of the law in this regard will aid asset securitization. However, the present writer agrees with Opasanya who highlighted the possible adverse consequence of holding as a general rule that the receiver/manager shall be the agent of the secured lender. This study submits that this adverse consequence may also negatively impact, by necessary implication, on asset securitization.

The study submits, with respect, that the decision in *Ubah v. Fidelity Bank Plc,*[660] has created uncertainty to the appropriate procedure for commencing an action for foreclosure and that the practical effect of the decision is to emasculate if not render otiose the provision of Order 51 of the Lagos Rules.

The study finds that foreclosure is an unpopular remedy resorted to by mortgagees in Nigeria and that it has several challenges highlighted in the chapter which create doubt as to its continuous utility or at the best makes reform of the law and procedure on foreclosure an imperative. The study therefore suggests that there is a need for reconsideration of the

[660] [2013] LPELR-20658 (CA).

Nigerian law on foreclosure. An opportunity to do so by the Lagos legislature in the enactment of the LSMP Law was not utilized.

It is further found that legal risks of the underlying security interests in asset securitization may manifest in the context of enforcement of the security interests. The study finds that in Nigeria, enforcement of security interests is susceptible to many difficulties such that even self-help remedies such as sale of the mortgaged properties are oftentimes subject matter of long drawn litigations oftentimes on puerile legal grounds concocted by the debtors to avoid enforcement and realization of the security as illustrated by the case of *Owoniboys Tech v. Union Bank of Nigeria.*[661]

A consideration of the LSMP Law was undertaken in this chapter. It is found that certain provisions of the Law are made applicable to both mortgages made before and after the commencement of the LSMP Law. The view of the present writer is that the practical implication of those provisions is to introduce legal incidence to mortgages not contemplated by the parties at the time they entered into mortgage transactions made before the commencement of the law. The status of Conveyancing Act 1881 under the law was also considered and the study submits that the side note to section 68 of the LSMP law is misleading and should be ignored in applying the provision, also that the legislature in Lagos can repeal the Conveyancing Act is debatable.

The study finds that the traditional modes of enforcement of mortgage, that is, enforcement of covenant to pay, entering into possession, sale of mortgaged property, appointment of

[661] [2003] 15 NWLR (Pt. 844) 545; (2003) 40 WRN 1.

receiver and foreclosure of equity of redemption were retained by the LSMP. The differences between LSMP Law and the Conveyancing Act on enforcement of mortgage by sale was examined and it is found that the LSMP Law has not effected substantial amendment of the law regulating exercise of power of sale and appointment of receiver in mortgage transactions. The study submits that failure of the LSMP Law to address the foreclosure issue, either to retain it and streamline the legal position and procedure, or to totally abolish it as has been done in some jurisdictions is a major drawback of the LSMP Law.

The chapter examines section 53 of the LSMP Law and finds that, and from the point of view of asset securitization, the provision of section 64 of the LSMP Law which makes making a mortgage security unenforceable for failure to register the mortgage instrument increases the due diligence requirements in structuring the transaction and as well introduces additional legal risk for asset securitization.

Notwithstanding some of the highlighted drawbacks of the LSMP Law, the study finds that there are provisions in the Law that may facilitate expeditious and judicious determination of disputes as well as enforcement of mortgage security. This will positively impact on structuring asset securitization. The study therefore suggests that there is much to commend to other state legislatures in the LSMP Law in reforming applicable mortgage law. The inevitable conclusion of the study is that there is a serious need for the reform of the enforcement regime for security interests under Nigerian law if the risk of the underlying security interests in asset securitization will be properly addressed.

Chapter Six

Structuring Asset Securitization in Nigeria: Legal and Constitutional Frameworks

6.1 Introduction

There are several legal issues associated with structuring of an asset securitisation. This is particularly apposite because of nascence of asset securitization in Nigeria and the fact that there is yet to be a specific legal framework for asset securitization. Therefore, it will be pertinent to examine legal provisions relevant to structuring an asset securitization deal in Nigeria. Apart from this, and in view of the federal nature of the Nigerian Constitution, the issue of legislative competence to make law on asset securitization also becomes relevant. The relevance of the constitutional issue is particularly in the context of suggestions for legislative reform for asset securitization.

Therefore, the focus of this chapter is twofold: to examine legal issues relevant in structuring asset securitization under the existing law; and to examine the issue of legislative competence to make law on asset securitization in view of the federal nature of the Nigerian Constitution.

6.2 Legal Framework for Asset Securitization in Nigeria

A good starting point to consider applicable legal framework to asset securitization in Nigeria is to highlight the basic process or structure of asset securitization. The basic structure of asset securitization is as follow:[662]

i. The originator either has or creates the underlying assets, that is, the transaction receivables that are to be securitized.

[662] V Kothari (n 6).

ii. The originator selects the receivables to be assigned.
iii. A Special Purpose Vehicle (SPV) is formed or an existing SPV is used.
iv. The SPV acquires the receivables, at their discounted value.
v. The SPV issues securities to investors--either debt type securities or beneficial interest certificates. These are publicly offered or privately placed, as found conducive.
vi. The servicer for the transaction is appointed, normally the originator.
vii. The debtors of the originator or obligors are/are not notified depending on the legal requirements of the country concerned. Most likely, the originator will try to avoid notification.
viii. The servicer collects the receivables, usually in an escrow mechanism, and pays off the collection to the SPV.
ix. The SPV either passes the collections to the investors, or reinvests the same to payoff to investors at stated intervals.
x. In case of any default, the servicer takes action against the debtors as the SPV's agent.
xi. When only a small amount of outstanding receivables are left to be collected, the originator usually cleans up the transaction by buying back the outstanding receivables.
xii. At the end of the transaction, the originator's profit, if retained and subject to any losses to the extent agreed by the originator, in the transaction is paid off.

The identified key aspects of the process of asset securitization as described have legal implications and require proper legal structuring to achieve the desired goals of securitization. These will be discussed hereafter.

6. 2. 1 Securitizable Receivables/Assets

In asset securitization, it is the receivables and not the loans that are securitised. In this regard, receivable means, "the right to receive payments of a sum of money at a future date, such as the right to receive interest payment on a loan".[663] The receivables are book debts, that is, receivables payable in consideration of, for example, goods sold or services rendered.[664] The legal significance in making a distinction between transfer of loans and transfer of receivables is that the transfer of the whole loans requires the consent of the borrower but the assignment of the receivables can be effected without such consent so far there is notification which may even be delayed.[665]

Depending on the kinds of companies' business the assets that can be securitised may be Loan receivables, [666] Commercial Mortgage Backed Securitization, (CMBS), and Real Estate Mortgage Backed Securitization, (RMBS),[667] Rental receivables,[668] Lease receivables[669]Rent receivables,[670]royalty receivables,[671] Energy bill receivables,[672] Exports Diversified Payment Rights, Telephone, and exchange bill receivables,[673] Fare earning receivables,[674] Synthetic securitization, and premium receivables, [675] Tax revenue receivables, [676] Development

[663] J V Robbe (n 11).
[664] ibid.
[665] ibid.
[666] For Banking and finance companies.
[667] Housing and mortgage finance.
[668] Car rental.
[669] Equipment leasing.
[670] Hotels.
[671] Energy Oil and Gas.
[672] Electricity supply.
[673] Telecommunication.
[674] Aviation and other transportations.
[675] Insurance.
[676] Tax collection.

assistance receivables,[677] Tuition fees receivables,[678] and Pension and other funds receivables.[679]

In Nigeria, in the class of receivables will be bank debts and loans and payments to utilities like various Electricity Distribution Companies, Housing Corporations, Water Corporations, as well as property and leasing companies. The receivables from these types of entities may be periodical, and also subject to various consumer credit, or utility, laws. For instance rent due on residential property cannot be changed arbitrarily going by the Tenancy Law 2014 of Lagos State.[680] Hire payments on hire purchase contracts are subject to the Hire Purchase Law.[681] Electricity tariffs are subject to statutory rules.[682] These rules may grant the obligors rights which may be commercially unacceptable to the SPV and indirectly, the investors. Besides, they may make it difficult to assign or vary terms of the receivables. Therefore, the possible applicable legal rules or constraints to the subject matter of the receivables need to be properly considered.

The assets to be securitised will be selected by the originator and the selection process is primarily driven by the desired tranching of the notes to be issued to investors.[683] The asset to be included must also have good credit quality. Ultimately, whether an asset will be included

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677 Development/aid organisation.
678 Educational establishments.
679 Fund management.
680 Law No. 14 of 2011.
681 See for instance, paragraph 14 of the Hire Purchase Regulations, Cap H4, Laws of the Federation of Nigeria, 2010 which provides that: "The true rate of interest required to be stated in the note or memorandum in accordance with the provisions of section 2 (2) (b) of the Act shall be calculated in accordance with the formula prescribed in the Fourth Schedule to these Regulations."
682 See, Electricity Power Sector Reform Act, 2005, No. 77, vol. 92, Federal Republic of Nigeria Official Gazzette, 8th August, 2005 and Nigerian Electricity Commission, Multi-Year Tariff Order (MYTO) for the period of 1 July, 2008 to 30 June 2013, Order No. NERC/GLO59.
683 J V Robbe (n 11) 12.

depends on the eligibility criteria for the assets as published by the rating agency enlisted to provide the credit rating on the various tranches of notes.[684] Thus, some assets may not be allowed in the pool or only at the expense of a penalty in the form of additional credit enhancement to achieve the desired rating level.[685]

Some of the traditional criteria for accepting an asset as being securitizable are:[686] the asset should give rise to cash flows over a period of time and the cash flows should be steady and easy to identify; the receivable being securitized must be of high quality;[687] the portfolio should be diversified such that no individual asset should have a significant value relative to the size of the portfolio;[688] the payment on account of the underlying assets should be periodic; the underlying assets should be homogeneous; the underlying contracts of the assets to be securitized must not be executory;[689] there must not be legal or contractual prohibition on assignment of the assets; the on-going performance of the assets and the making of claims against the debtors must be independent of the existence of the originator; and the receivables should generally be free of withholding taxes.[690]

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684 ibid.

685 Ibid.

686 V Kothari (n 6) 30-33.

687 Even though past payment is generally taken as a yardstick of quality, there will be additional quality if the securitised receivable has any collateral protection, such as guarantees, title or right over an asset, negotiable instruments, etc. backing it- V Kothari, (n 6) 30.

688 The degree of diversification is an important issue in the rating of the portfolio.

689 "Executory" in this sense means that there are clauses placing the obligation to carry out certain acts in relation to the securitised assets, e.g. that the originator should maintain the assets. This feature has legal implication because rights can be transferred but not obligations. Thus, if the underlying contract has an obligation on the part of the issuer that cannot be transferred independent of the obligation, the securitisation will not work- V Kothari, (n 6) 32.

690 Complicated questions may arise if withholding taxes are applicable on the payments made to the debtor. One is who will take the credit for the withholding tax. According to Kothari, "The payment is collected by the originator, but on behalf of the SPV, which in turn collects it on behalf of the investors. It would be logically impossible to allow the benefit of set off to the investors directly; therefore, the SPV or the originator will be forced to take the credit for the pre-paid tax, which may be technically objectionable". Second is the question of time to take the set-off. According to Kothari, "usually, withholding taxes only qualify for a refund after the tax assessment is complete, that may take time. This would

6. 2. 2 Assignment of Future, Potential and Contingent Chose in Action

In the context of securitizable receivables, it may be worth examining, even if for purpose of theoretical relevance, issue of possibility or otherwise of assignment of future, potential and contingent chose in action. While, it may be undisputable that present, future and potential receivables can be assigned, there may be some controversies as to whether a contingent right can be assigned. Relying on the *tree and fruit* analogy, it may be contended that in cases of purported assignment of contingent rights, there was no contractual tree from which receivables could flow as fruits. It is however submitted that this argument may not be correct. Even though future receivables were unassignable at common law, equity took a different position. Thus, where a party assigns to another a right he expected to fall to his luck at a later date for valuable consideration, the agreement is binding and enforceable when the right finally vests in the assignor.[691]

In *Bennett v. Cooper*,[692] a mortgagor assigned by way of equity 'all sums of money then or thereafter to become due to him, and all legacies or bequests which had already or might thereafter be given or bequeathed to him or his wife, by any person whomsoever.' Lord Langdale MR held valid the transaction. It is submitted that no future right could be more contingent than the ones in this case. First, it comprehends all persons who might intend to benefit the mortgagor dying testate and not otherwise. Second, it assumes that such persons would actually benefit the mortgagor in their wills the possibility of which was not certain. Third, the mortgagor's morbid optimism extended his luck to such legacies and bequests as

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create difficulties in securitisation structure by creating a residuary receivable that may be collected much after the expiry of the scheme".- V Kothari, (n 6) 33.

691 *Holroyd v. Marshall* (1862) 10 HL Cas 191.

692 [1846] 9 Beav 252.

might even be given his wife! Despite this, the court gave effect to the transaction as the rights had crystallised as at the enforcement date. The event of death of those who might benefit the assignor cannot be treated as a contingency as it is bound to happen. It is only the time of such deaths and the possibility of intended benefits that are contingencies not capable of determination at the date of contract. Later decisions in *Holroyd v. Marshall*[693] and *Tailby v. Official Receiver*[694] remain reference points on this issue. The conditions necessary for the right to attach are merely that:

1. the assignee must have given consideration and not merely that the contract was made by deed as equity would not assist a volunteer
2. on the coming into existence of the chose expected, it shall answer the description in the assignment or, in other words, that it shall be capable of being identified as the thing, or as one of the very things assigned.

Where the two above are present at the date of contest for enforcement, the assignment is enforceable. This only indicates that no condition must be left on the said date. Where no consideration has been given, the assignment is completely voluntary, and then no assignment has been done. Cases like *Meek v. Kettlewell*[695], (assignment of an expectancy under seal); *Re Ellenborough*[696] (assignment of expected bequests and legacies arising in the event of the assignor's brother and sister's respective wills and intestacies); *Re Brook's Settlement Trusts*[697] (assignment of interest in a trust fund over which the assignor's mother held a power

[693] 10 HL Cas 191.
[694] (1888) 13 App Cas 523 (HL).
[695] (1842) 1 Hare 464.
[696] (1903) 1 Ch.D 697.
[697] (1939) Ch.D 993.

of appointment) are distinguishable as they all involved voluntary assignment not supported by any consideration whatsoever. The present state of the law has therefore gone beyond the issue of unassignability of future, potential and contingent receivables.[698]

It may be safe to submit that, in the context of asset securitization, future, potential and contingent receivables may not be securitizable assets for the fact that the receivables may not yield to cash flows that is steady and easy to identify.

6.2.3 The Special Purpose Vehicle (SPV)

The Special Purpose Vehicles serves as intermediary between the originator and investors and its establishment is the "first building block of virtually all securitisations."[699] It is by through the SPV that the dual objectives of transferring assets to the investors and at the same time creating a capital market instrument are achieved.[700] The SPV is created for "the single purpose of holding the assets sought to be transferred by the originator and the subsequent issuance of securities such that the securities are no different from a claim over the assets".[701]

In terms of formation, since the SPV will usually issue its securities to the public, under the existing law, the SPV should be formed as a public limited company. This is because by section 22 of CAMA, a private company must by its articles restrict the transferability of its

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698 For a detailed and correct assessment of the position of the law on this issue, F Oditah (n 322) 27 – 32.

699 J V Robbe (n 11) 15. It was however pointed out that, in exceptional instances, securitisations are structured without an SPV. Where this is the case "the note holders are not isolated from the credit risk of the originator. The credit rating of the notes issued by the originator is then capped at the originator's credit rating. In addition, a change (including downgrade) of the rating of the originator could then directly affect the rating of the notes issued. The issuance of AAA rated notes with a certain degree of expected rating stability would thus be rendered very difficult indeed"- J V Robbe (n 11), 15-16.

700 F J Fabozzi and V Kothari (n 11).

701 ibid.

shares,[702] its members must not exceed fifty[703] and a private company shall not, unless authorised by law, invite the public to subscribe for any shares or debentures of the company.[704] Further, by section 67(1) of Investment and Securities Act, it would appear that unless a statutory body or bank established by or pursuant to an Act of the National Assembly and is empowered to accept deposits and savings from the public or issue its own securities (as defined under this Act), promissory notes, bills of exchange and other instruments,[705] it is mandatory that a person making any invitation to the public to acquire or dispose any securities of a body corporate or to deposit money with any corporate body for a fixed or payable at call, whether bearing or not bearing interest unless the body corporate concerned must be a public company, whether quoted or unquoted, and there must be compliance with the provisions of sections 73 - 87 of the Act.[706]

It is also pertinent to note that notwithstanding that it is a SPV and established to carry out the assignment of asset securitization for the originator, the SPV must still fulfil its obligations under the law[707] as for instance filing of annual returns with the Corporate Affairs Commission[708] and filing of annual tax returns with the Federal Board on Inland Revenue.[709]

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[702] Section 22(2) of CAMA, Cap C20 Laws of the Federation of Nigeria, 2010.

[703] Section 22(3) of CAMA 2010.

[704] Section 22(5)(a) of CAMA..

[705] Note also the proviso to section 67(1) of the Investment and Securities Act, 2007 that nothing in the subsection shall render unlawful the sale of any shares by or under the supervision of any court or tribunal as may be authorised by law.

[706] There are both criminal and civil consequences for contravention of the provision of section 67(1) of the ISA, 2007- See section 67(2)(3) and (4) of the ISA.

[707] *Marina Nominees Ltd. v. F.B.I.R.* [1986] 2 NWLR (Pt. 20) 48 at 58. The Supreme Court held that "the device of agency by using one incorporated company for the purpose of carrying on an assignment for another company or person must not overlook the fact that that incorporated company is a separate legal entity which must fulfil its own obligations under the law".

[708] Section 370 of CAMA. Section 371 of CAMA provides that the annual returns of a company having shares other than a small company shall contain with respect to the registered office of the company, registers of members and debenture holders, shares and debentures, indebtedness, past and present members and directors and secretary, the matters specified

A fundamental objective in structuring of the SPV is to attain bankruptcy remoteness, that is, that the possibility of the SPV becoming bankrupt or insolvent should be remote. The whole essence of asset securitization will be defeated if the SPV can easily become bankrupt or insolvent. Bankruptcy remoteness is achieved by the following mechanisms; isolating the ownership and control of the SPV from the originator; restricting the business dealings of the SPV; imposing certain restrictions on the purchaser of the notes; and by reducing if not eliminating the risk of claw-back by an insolvency officer if the SPV in any event become insolvent.[710] These mechanisms dictate certain features that the SPV must have from the legal perspective with a view to safeguarding the interests of the investors.

First, in isolating the ownership and control of the SPV from the originator, the SPV should be structured such that the legal control and ownership would not be said to be in the originator. The SPV should also not be structured in such a manner that it will be regarded as the subsidiary of the originator and this may have accounting consequences. The issue of isolating ownership and control is important because even though a subsidiary company has its own separate legal personality and generally the act of a subsidiary company cannot be imputed to the parent company or vice versa,[711] where there is evidence that a company is a subsidiary of others and was operating on behalf of them, if the companies are to all intent

in Part I of the Eighth Schedule to the Act, and the said return shall be in the form set out in Part II of that Schedule or as near to it as circumstances admit.

[709] Section 55(1) of Companies Income Tax Act, Cap C21, LFN, 2010 provides that: "Every company, including a company granted exemption from incorporation, shall, at least once a year without notice or demand therefrom, file a return with the Board in the prescribed form and containing prescribed information together with the following—(a) the audited accounts, tax and capital allowances computations and a true and correct statement in writing containing the amounts of its profits from each and every source computed in accordance with the provisions of this Act and any rules made thereunder; (b) such particulars as may by such form or return be required for the purpose of this Act and any rules made thereunder, with respect to such profits, allowances, reliefs, deductions or otherwise as may be material under or by virtue of this Act and such rules."

[710] J V Robbe (n 11), 16. See also 17 – 18.

[711] *Union Beverages Ltd. v. Pepsicola Int. Ltd* [1994] 3 NWLR (Pt. 330) 1 at 16.

and purposes one, then their corporate veil could be pierced and each would be liable for the action of the other.[712]

Second, the SPV must not carry out any form of trading or obtain external funding. The SPV must be structured as a single purpose entity such that it cannot engage in any activity other than holding and maintaining interest in the securitized portfolios.[713] The business or object of the SPV should be restricted to the matters contemplated by the transaction and entering into ancillary arrangements necessary for the transaction like performance of its obligations under the transaction documents, acquisition of collateral from repurchase counterparty and the encumbering of the collateral in favour of the security trustee.[714] This is necessary so that SPV would not introduce new and different risk factors which would endanger the transaction.[715] Also, these restrictions would minimize the risk of default by the SPV in the course of the transaction. Additionally, there will be certain covenants to be entered by the SPV to ensure its separateness. For instance, covenant that the SPV will not merge or reorganise, maintains its books, records and accounts separate and maintain separate financial statements.[716]

Third, all services required to maintain the SPV and its assets, for example, administration of its receivables and secretarial work, will be sub-contracted. Thus, SPVs are not permitted to have any employees or (normally) to have general fiduciary responsibilities to third parties, as for instance, acting as a trustee. The subcontracting or outsourcing of administrative functions

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712 supra at 21-22.
713 V Kothari (n 6) 35.
714 J V Robbe (n 11) 17.
715 V Kothari (n 6) 35.
716 J V Robbe (n 11) 17.

is normally done through a servicing agreement, which defines the different tasks, to be carried out by the servicer, that are necessary to permit the SPV to conduct its business. These services range from collection of cash each day; operating bank accounts; enforcing agreements with the underlying debtors like collecting on security and chasing borrowers who are in arrears; company secretarial matters; accounting; taxation (depending upon the jurisdiction concerned, the taxes may include income-tax, VAT, stamp duty.); reporting to investors, rating agencies and trustees; pool management which may involve dealing with requests for additional funds and changes to the asset contracts; and management of related insurance. It may also be necessary to hire the services of an investment manager or investment adviser where the SPV also has to invest or reinvest cash-flows. [717]

Fourthly, it may be necessary to insert in agreement made by the SPV that any person who contracts with the SPV agrees not to sue the SPV in the event the SPV fails to perform under the contract. [718] Also, the rating agencies criteria would require that certain restrictions on the rights and actions of the note holders are inserted in the terms and conditions of the notes. In this regard, there may be clause that the notes are limited recourse. This means that recourse by the note holders as well as other secured parties like swap counterparts and deposit banks is limited to the collateral and other assets of the SPV encumbered in relation to the particular transaction.

The practical implication of the limited recourse clause is that the creditors will have no right to claim any shortfall from either the SPV or the originator. There may also be clause to the

[717] V Kothari (n 6) 35.
[718] ibid.

effect that there will be no petition for bankruptcy of the SPV.[719] Issue may of course arise whether a clause prohibiting petitioning for bankruptcy or winding up of the SPV will be enforceable under the Nigerian Law. It is submitted that such clause may not be enforceable under the Nigerian Law, the right to petition for winding up being statutory and under stipulated circumstances.[720] Be that as it may, while the limited recourse and non-petition provision may not be enforceable, they may be made effectual by the mechanism of security trustee whereby by the terms of the trust deed, parties agree that it is only through the security trustee that action may be taken against the SPV.

Fifth, it is also important that all of the SPV's liabilities (present and future) should be quantifiable, and shown to be capable of being met out of the resources available to the SPV.[721]

6.2.4 Transfer of Assets/Receivables to the SPV

In asset securitization, the assets pools that have been selected for the securitization are transferred to the SPV. The transfer of the assets is crucial to the transaction. Thus, care must be taken that the transfer of the assets is legally binding and that the transfer is regarded in law as a true sale so as to avoid the risk of re-characterization and the attendant consequences.

The usual means by which the assets/receivables are transferred to the SPV is by an assignment which means a transfer of right.[722] The legal aspects of assignments of receivables

[719] J V Robbe (n 11), 17.
[720] See section 408 of CAMA for circumstances under which a company may be wound up and Section 410 of CAMA for persons that can present petition for winding up.
[721] V Kothari (n 6) 35.
[722] M I Jegede (n 253) 174.

under the Nigerian Law still reflects the dichotomy between law and equity as handed down by the received English Law. The assignment can be legal or statutory assignment, or equitable assignment.

6.2.4.1 Legal or Statutory Assignment

The common law rule against assignment of chose in action was replaced in 1875 by statutory provision permitting legal assignment. This was done through section 25(6) of the Judicature Act 1875 which is a statute of general application.[723] There are similar provision in section 150(1) of Property and Conveyancing Law[724] and section 147(1) of the Property Law.[725]

Section 150(1) of Property and Conveyancing Law provides:

> "Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal thing in action, of which express notice in writing has been given to the Debtor, trustee or other person from whom the assignor would have been entitled to claim such debt or thing in action, is effectual in law(subject to equities having priority over the right of the assignee) to pass and transfer from the date of such notice-
>
> (a) the legal right to such debt or thing in action:
>
> (b) all legal and other remedies for the same: and
>
> (c) the power to give a good discharge for the same without the concurrence of the assignor:
>
> Provided that, if the debtor, trustee or other person liable in respect of such debt or thing in action has notice-
>
> (a) that the assignment is disputed by the assignor or any person claiming under him; or

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723 See, for example, section 32 on the Interpretation Act, Cap I23 LFN, 2010 which provides "Subject to the provisions of this section and except in so far as other provision is made by any Federal law, the common law of England and the doctrines of equity, together with the statutes of general application that were in force in England on the 1st day of January, 1900, shall, in so far as they relate to any matter within the legislative competence of the Federal legislature, be in force in Nigeria." I O Bolodeoku, (n 193) 23-31 on received English Law as a source of Nigerian Law. A O Obilade (n 193) 69 - "The received English Law consists of the common law, doctrines of equity, statutes and subsidiary legislation." "The received English Law remains a veritable source of Nigerian law"- D Olowu and F Lasebikan (n 56) 245-6; N Tobi (n 56) 6, 17, 21-3.

724 See for example cap 132, The Laws of Osun State of Nigeria, 2002. There are identical provisions in the laws of Oyo, Ogun, Ondo, Ekiti, Edo and Delta States.

725 Cap P10, Laws of Kwara State of Nigeria, 2006.

> of any other opposing or conflicting claims to such debt or thing in action; he may, if he thinks fit, either call upon the persons making claim thereto to interplead concerning the same, or pay the pay the debt or other thing in action into court under the provisions of the Trustee Law".[726]

It must first be pointed out that to come under the provision; there must be an assignment and not a mere direction to the person under liability to pay a third party.[727] Therefore, a revocable authority or direction to a debtor to pay the debt to a third party is not an assignment for the purpose of the provision.[728]

Based on the statutory provisions, the following are necessary to create valid legal assignment:

(a) the assignment must be in writing under the hand of the assignor and must be of a 'debt or other legal things in action';

(b) the assignment must be absolute; and

(c) the assignment must not purport to be by way of charge only.[729]

In *Udukason Ent (Nig) Ltd v. Olisa*,[730] the court held that the conditions which must be complied with for a legal assignment for the purpose of the statutory provision are: that the assignment must be in writing under the hand of the assignor; that the assignment must be absolute not purporting to be by way of charge only; and that express notice in writing of the assignment must be given to the debtor.

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[726] This provision is identical with section 136(1) of the Law of Property Act 1925 (UK) and section 12 of Conveyancing Act of the New South Wales- See, P W Young, C Croft and M L Smith, *On Equity* (Thomson Reuters, Sydney, 2009) 691.

[727] See *Curran v. Newpark Cinemas Ltd* [1951] 1 All ER 295 at 299.

[728] M I Jegede (n 253) 193.

[729] See P W Young, C Croft and M L Smith (n 726) 693 and M I Jegede (n 253) 193-4.

[730] (1972) ECSLR 171.

There is no prescribed form for the assignment but it must be in writing and under the hand of the assignor. Also, the assignment need not be by deed but usage of deed does not affect the application of the provision.[731] The signature of the agent of the assignor in his own name will not be sufficient[732] except the agent sign in the name of the principal in which case this may be sufficient.[733] Since the assignor, in asset securitization transaction, will invariably be a company, the requirement of the assignment being in writing and under the hand of the assignor will be met by compliance with section 78(1)(b) of CAMA to the effect that "any contract which if made between individuals would be by law required to be in writing, signed by the parties to be charged therewith, or which could be varied or discharged only by writing or written evidence signed by the parties to be charged, may be made, varied or discharged, as the case may be, in writing signed in the name or on behalf of the company". Thus, signature by an agent or officer of the company in the name or on behalf of the company may suffice but prudence may dictate that the assignment be signed by at least a director and the secretary of the company in the name and on behalf of the company.

It is also required that the assignment must be of a 'debt or other legal thing in action.' This expression presupposes that, at the date of the assignment, there must be an existing debt or a legal thing in action, the existence of a right arising out of contract and thus the expression

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[731] *Merchant v. Morton, Down and Co* [1901] 2 KB 829.
[732] *Wilson v. Wallani* (1880) 5 Ex D 155.
[733] See F M B Reynolds, *Bowstead & Reynolds of Agency* (16th edn, Sweet & Maxwell, London, 1996) para 2-023.

includes a debt that has not fallen due or is not yet payable.[734] The assignment must also be absolute. In *Curran v. Newpark Cinemas Ltd*[735] Jenkins L.J held:

> It is, no doubt, true that s. 136(1) does not require any particular form of assignment, or that the notice given to the debtor should necessarily have been given by the assignee. The sub-section does, however, clearly postulate that, whatever its form, there should be a document amounting to an absolute assignment by writing under the hand of the assignor. Given such an assignment, and given the requisite notice to the debtor, the assignment (to put it shortly) is to operate as a legal assignment of the debt in question. Section 136 (1), however, does not provide that a document which would not, independently of the sub-section or its predecessor (Supreme Court of Judicature Act, 1873, s. 25 (6)), have operated as an absolute assignment at law or in equity is to have the force of an absolute assignment for the purposes of the sub-section. The document here relied on is the direction and authority, which in point of form is not an assignment to the bank of the debt in question but merely a direction to the garnishees to pay the debt in question to the bank.

An assignment would not be regarded as an absolute one if the assignor retains a beneficial interest in the chose in action or if the assignment is of only part of the chose in action.[736] In *W.N.F.C. v. West Coast Builders Ltd*,[737] the defendant assigned 25% of the moneys due to the company from the Ministry of Works. The court held that the assignment cannot be a legal assignment under section 150 of the Property and Conveyancing Law as it was an assignment of part of the whole debt. Such an assignment of the part of the chose in action may only take effect as an equitable assignment.[738]

Further, a conditional assignment which becomes operative or ceases to be operative upon the happening of an event would not meet the requirement of absolute assignment under the provision.[739] Also, assignment by way of charge is not an absolute assignment.[740] Whether an

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[734] See, *Walker v. Bradford Old Bank* (1884) 12 QBD. 511; *Torkington v. Magee* [1902] 2 K.B. 427; *Re Paine [*1919] 1 Ch.D 38.
[735] [1951] All ER 295 at 299.
[736] *Williams v. Atlantic Insurance Co Ltd* [1933] 1 KB 81; *Walter and Sullivan Ltd v. Murphy and Sons Ltd* [1955] 2 QB 584; and *Deposit Protection Board v. Dalia* [1994] AC 367 at 380.
[737] (1971) 1 UILR. 93
[738] See *Mercantile Bank v. Evans* (1899) 2 Q.B. 613.
[739] *Durham Bros v. Robertson* [1898] 1 QB 765, 773; *Hughes v. Pump House Hotel Co Ltd* [1902] 2 KB 190 at 196.
[740] *Jones v. Humphreys* (1902) 1 KB 10.

assignment is absolute or whether an instrument is intended to operate as an assignment at all will ultimately be determined upon construction of the relevant instrument.[741] This will also depend on the intention of the assignor and the language used in the relevant instrument.[742] It would, however, appear that the court would take a liberal approach in finding that there is an assignment from the relevant instrument.[743]

For the assignee to obtain legal right to the receivables, written notice must be given to the debtor and the right of action in respect of the assignment is transferred.[744] In *Udukason Ent (Nig) Ltd v. Olisa*,[745] it was held that a letter to the debtor that Udukason (Nig.) Enterprises has been registered as a limited liability company and requesting that the defendant debtor henceforth deal with the plaintiff company constitute sufficient notice to the defendant that the assets (which include the defendant's debt) of the dissolved partnership had been assigned to the plaintiff.[746]

Transfer of receivables by way of legal assignment appears to be "the cleanest" because "it ensures that the sale is immediately effective against the seller, its trustee in bankruptcy (subject to the risk of claw-back) as well as the obligors of the securitized assets."[747] From a practical perspective, a legal assignment is less attractive to the originator because of the requirement of notice to the borrowers as "originating banks are generally not keen to notify

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741 P W Young, C Croft and M L Smith, (n 726) 695. See also, *Hughes v. Pump House Hotel Co Ltd* [1902] 2 KB 190 at 193.

742 P W Young, C Croft and M L Smith, (n 726) 696.

743 *Udukason Ent (Nig) Ltd v. Olisa* (1972) ECSLR 171 the court held that even though the court held that the agreement "undoubtedly was inelegantly drafted", the court held that "notwithstanding the contents show clearly that all the assets and liabilities of the dissolved partnership have been transferred to the plaintiff"- at 175.

744 *Udukason Ent (Nig) Ltd v. Olisa* (1972) ECSLR 171.

745 (1972) ECSLR 171.

746 (1972) ECSLR 171 at 175.

747 J V Robbe (n 11), 22.

their clients of the fact that the receivables owed under their (mortgage loan or other contracts) have been assigned to some unknown special purpose vehicle" and it is unlikely that the clients would appreciate the benefits the securitization transaction will bring to the bank.[748] It will also be impractical and too expensive if notice must be given to several obligors of the receivables purchased by an SPV. Another problem with legal assignment is that the debt assigned must be current, that is, legal assignment cannot relate to a future debt which was not in existence at the time of the transfer.[749]

6.2.4.2 Equitable Assignment

Recourse is made to equitable assignment because of the identified challenges of legal assignment. In assignment of legal or equitable chose in action, equity did not follow the common law as equity have always recognised and enforced assignments of all chose in action.[750]

Generally, there is no prescribed particular form for a valid assignment in equity provided the intention to assign is clear.[751] In this regard, to constitute an assignment, there must be a specific direction given on how a particular subject-matter of the transaction has to be disposed such that the direction gives right or interest to a third party in the subject-matter and

[748] ibid.
[749] ibid.
[750] M I Jegede (n 253) 176. See *Rodick v. Gandell* (1852) 1 De G.M. & G. 763. See also *Fitzroy v. Cave* (1905) 2 K.B. 364 for the reason for flexibility of equity to recognition and enforcement of chose in action.
[751] M I Jegede (n 253), 178.

not merely a mandate which is an intimation or mere giving of an information by one party to the other as to the disposition of the subject matter.[752]

It is also necessary that the property which is the subject matter of the assignment should be capable of being ascertained and identified.[753] Thus, a mere direction by a creditor to a debtor to pay a specified sum of money to a third party, without specifying a particular fund, will not constitute an equitable assignment.[754] However, in *Brice v. Bannister*,[755] the court upheld assignment of a specific debt out of a greater indebtedness, as between the assignor and a particular debtor.

In *Williams Brandts Sons and Co. v. Dunlop Rubber Co. Ltd*,[756] the House of Lord held that an equitable assignment does not have to take any prescribed form and that it may be couched in the language of command, it may be a courteous request or it may assume the form of permission. So far as the meaning is plain, the language is immaterial. There may also be valid oral assignment in equity;[757] except that where there is statute prescribing that disposition of certain interest must be in writing,[758] oral assignment of such an interest will not be valid.[759] For an equitable assignment to be valid, the assignment must be communicated to the assignee. Therefore, even though the consent of the person who is to

752 M I Jegede (n 253), 177. See also, *Scott v. Porcher* (1817) 3 Mer 652 and *Watson v. Duke of Wellignton* (1830) 1 R & M 602.
753 *Tailby v. Official Receiver* (1888) 13 App Cas 523 at 528,543 (HL).
754 *Percival v. Dunn* (1885) 29 Ch.D 128.
755 (1878) 3 QBD 569.
756 [1905] AC 454.
757 See *Thomas v. Harris* [1947] 1 All ER 444.
758 See for example section 9 of the Statute of Frauds, 1677 (a statute of general application) and section 78(1)(c) of the Property and Conveyancing Law.
759 See *Grey v. I.R.C.* (1959) 3 WLR 758 and *Oughtred v. IRC* (1959) 3 WLR 898.

discharge the liability is not necessary, the assignment must be communicated to the assignee.[760]

Whether or not consideration is required to support the equitable assignment would depend on the type of property being assigned as well as the form of the assignment.[761] The issues of whether consideration is necessary and whether it has been given will only affect rights as between assignors and assignees, thus, the absence of valuable consideration would not justify a debtor recognising the assignee's interest in the debt.[762] In view of this and the fact that hardly will the originator raise the issue of lack of consideration against the SPV coupled with the fact that, in the context of asset securitization, there will almost always be consideration for the transfer of the assets or receivables by the originator to the SPV, no useful purpose will be served by analysing the relevant situations where consideration is necessary or not in this work.[763]

6.2.4.2.1 Implications of Equitable Assignment

As noted above, there is preference for equitable assignment because there is a valid equitable assignment without notice to the debtor. The absence of notice may, however, have some other effects.[764] Firstly, the SPV might lose priority if the originator resells or charges the receivables to a third party. In other to mitigate this problem a clause is usually inserted in the

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760 See *Rekstin v. Severo etc and Bank for Russia Trade Ltd* [1933] 1 KB 47; *Curran v. Newpark Cinemas Ltd* [1951] 1 All ER 295.

761 See, P W Young, C Croft and M L Smith, (n 726) 710-713. and M I Jegede, (n 253) 179-181.

762 *Walker v. Bradford Old Bank* (1884) 12 QBD 511.

763 Interested readers may however refer to P W Young, C Croft and M L Smith, (n 726) 710-713 and M I Jegede, (n 253) 179-181.

764 It has been pointed out that notice serves four purposes: (i) to maintain the assignee's priority; (ii) to prevent equities arising as between assignor and debtor to which the assignee might be subject; (iii) to prevent the debtor from obtaining a discharge from the assignor; and (iv) to bind the debtor's conscience- See P W Young, C Croft and M L Smith, (n 726) 709.

transfer agreement prohibiting this and rating agencies are content to rely on the SPV complying with the prohibition. Secondly, debtors can continue to pay the originator but this is not a problem because the originator wishes to continue to collect and that this is the most convenient from the point of view of the parties involved. But then the continued collection by the originator may pose co-mingling risk. In other to mitigate this, a separate account may be set up in the name of the originator and the direct debit mandates given by the debtor may be amended or payments made by direct debit may be paid direct to the SPV's account rather via the originator. Thirdly, debtors can continue to acquire new set-offs. The effect of this will be to diminish the receivables where set-off by the debtor is possible. Fourthly, the originator can vary the terms of the receivables. Lastly, it would be necessary to join the originator in an action by the SPV against the debtor.[765]

6.2.4.2.2 Assignee Taking Subject to Equities

The general rule is that an assignee takes subject to equities irrespective of whether the assignment is legal or equitable. The implication of this rule is that the assignee takes subject to all rights of set-off and other defences that were available to the person under liability against the assignor at the date the person under liability received the notice of the assignment.[766] In asset securitization, the practical implication of this is that receivables that are susceptible to rights of set-off and counter claim may be negatively impacted.

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[765] P R Wood (n 196) 134-5, para 6-045. See also J V Robbe (n 11), 22.

[766] *Roxburghe v. Cox* (1881) 17 Ch.D. 520; *Biggerstaff v. Rowatt's Wharf Ltd* (1896) 2 Ch.D 93.

6.2.4.3 Assignability

In resorting to assignment as a means of transfer of the receivable, it is important to properly scrutinise the underlying contracts and determine whether there is express prohibition on assignment because, as a matter of law, an assignment contravening an express prohibition on assignments is void irrespective of whether the assignee was aware of the restriction.[767] However, the courts construe restrictions on transfer narrowly since the law prefers the free marketability of property.[768]

Also, there are situations where the consent of the debtors is needed for the valid assignment of the receivables and this may be due to various reasons including terms of the contracts applying to the receivables, the receivables relating to personal contracts, there are contractual prohibitions or there are official guidelines for the protection of consumers or home owners. In this situation securitization is impracticable because of "debtor inertia in replying" and there are "usually just too many debtors.[769]

Alternatives to assignment might include a trust of the receivables, a trust of proceeds, sub-participations or a novation.[770] Novation will, however, require the consent of the debtors and this may not be forthcoming and the alternative will have to contend with the problem of the large numbers of the debtors involved.

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[767] *Linden Gardens Trusts Ltd v. Lenesta Sludge Ltd* [1993] 3 All ER 417. HL (assignment of asbestos-removal contract with "non-assignment" clause was void).

[768] P R Wood (n 196) 133, para 6-042. The court will construe a prohibition on assignment as prohibiting only absolute assignment and not assignment by way of security or a floating charge.

[769] ibid, 131-2, para 6-040.

[770] ibid, 132, para 6-042.

6.2.4.4 Trust of Receivables/proceeds and/or transfer of Proceeds

An express restriction on assignment may not prevent an assignment of the proceeds or a trust of the debt.[771] Also, an express prohibition on assignment would not prevent a trust of the claim.[772] However, there is limitation to the benefits conferred by assignment of the proceeds because an assignee of proceeds cannot sue for the debt itself.[773] It may, however, be possible for a beneficiary under a trust to compel the trustee to sue.[774] Thus, the usual practice in the case of trusts of the claims is for the transferor/trustee to grant the beneficiary a power of attorney to sue, manage and collect.

The trust structure entails a transfer of the receivables to a trustee who holds on behalf of the investors and the Originator. Realizations are then paid to investors who are issued Pass-Through Certificates. The receivables are managed by the Originator who will take a share in the proceeds upon realization. Trust, a vehicle widely used in the US, will confront challenges to its utilization in Nigeria. First, trust is not of wide use in Nigeria. Secondly, the trust structure is driven by peculiar tax and accounting laws in the US which have no application, in Nigeria.

6.2.4.5 Sub-participation

A way out of the problem of restriction of assignment is to resort to sub-participation. The structure of sub-participation is that the seller grants sub-participations in the receivables to an

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[771] See *Gregg v. Brown* [1912] 3 KB 474; *Re Turcan* [1888] 40 Ch.D 5; *Russell & Co. v. Austin Fryers* [1909] 25 TLR 414; *The Liston Pride* [1985] 1 Llyods Rep 437 and *Re Irving, ex p Brett* [1877] 7 Ch.D 419.

[772] *Don King Productions Inc v. Warren* [1999] 2 All ER 218 (assignment of restricted boxing promotion contracts to a partnership. It was held that the assignor held them in trust for the partnership).

[773] *Floor v. Shand Construction Ltd*, The Times, January 8, 1997.

[774] *Barbados Trust Co Ltd v. Bank of Zambia* [2007] EWCA Civ 148.

SPV. The SPV borrows from investors via a bond issue and uses the proceeds to place a deposit with the originator. The terms of this deposit are that the originator must repay the deposit plus interest only if and to the extent that the originator recovers principal and interest on the receivables – a conduit loan.[775]

Therefore, under sub-participation, the originator is a conditional debtor to the SPV with the effect that the SPV and hence its investors carry the risk of non-payment of the receivables, as opposed to the originator, because if the debtors do not pay the originator, the originator does not have to pay the deposit to the SPV.

Unlike in asset securitization, the seller does not declare a trust or charge of the receivables to investors. Therefore, a disadvantage of sub-participation is that the investors take a double credit risk, that is, the risk of the receivables and the risk of the originator. Thus, if the originator becomes insolvent, the SPV can only claim the deposit as a creditor and cannot take over the receivables since the originator has not transferred or charged these to the SPV. Also, unlike asset securitization, sub-participation may not succeed in being off-balance sheet or avoid capital adequacy requirements.[776] Evidently, sub-participation does not amount to asset securitization.

6.2.4.6 Novation

Even though novation may be considered an alternative to assignment due to problem of un-assignability, it will require the consent of the debtors. This is because the effect of a

[775] P R Wood (n 196) 111, para 6-022.
[776] ibid, 111, para 6-022.

novation, which is a tripartite agreement, is to rescind the original agreement between the parties and replace it with a new contract.[777] The main problem with novation is that the requisite consent may not be forthcoming; also resorting to novation will have to contend with the problem of the large numbers of the debtors involved. Novation requires customer signature. It is thus impractical to obtain these consents and enter into large numbers of tripartite agreements to effect a securitization transaction. This is beside the cost and time implications of novation.

6.2.5 Transfer of Security Interests

Aside the transfer of the assets or receivables, it would also be necessary for the originator to assign the security interests supporting the assets or receivables to the SPV. This transfer is usually by way of assignment. Following the decision in *Re Tahiti Cotton Co., Exp. Sargent,*[778] a mortgage, being a right in property can be assigned, with or without the mortgagor's consent. It will thus be a question of contract whether a mortgagee can transfer its mortgage. If the deed prohibits a transfer of the mortgage, an assignment in contravention will be unenforceable.[779]

The assignment of the security interests is required because the SPV cannot enforce the underlying security where there was no valid assignment and registration of the security interest in favour of the SPV.[780] Transfer of security interests may include assignment of endowment insurance, of guarantees of the receivables and of any security for the receivables.

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777 M I Jegede (n 253) 174.
778 (1873) LR 17 Eq 273, p. 279.
779 See *Re Rumney and Smith* [1897] 12 Ch.D 351.
780 See *Paragon Finance Plc v. Pender* [2005] EWCA Civ 760; [2005] All ER (D) 307.

In England, the cost of registration, such as land registry fees, is usually avoided by an equitable (unregistered) assignment.[781] In Nigeria, however, where the security is a mortgage of land, consent of the local government or the governor is mandatory. Sections 21[782] and 22[783] of the Land Use Act prescribe the requirement of consent of the Local Government or the Governor for any form of alienation of a right of occupancy. The Act also provides that failure to obtain consent as to any alienation of a right of occupancy will render the underlying transaction null and void.[784]

In Lagos State, transfer of underlying security in asset securitization, where the security is mortgage, will benefit from the provision of section 46 of the LSMP Law. The section provides that, subject to express contrary intention and any provision in the deed, a deed executed by a mortgagee purporting to transfer his mortgage or the benefit of it shall operate to transfer to the transferee –

(a) the right to demand, sue for, recover and give receipts for the mortgage money or the unpaid part of it, and the interest then due, if any, and subsequently to become due on it;

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781 P R Wood (n 196), 132 para 6-047.

782 Section 21, Land Use Act provides: "It shall not be lawful for any customary right of occupancy or any part thereof to be alienated by assignment, mortgage, transfer of possession, sublease or otherwise howsoever: (a) without the consent of the Governor in cases where the property is to be sold by or under the order of any court under the provisions of the applicable Sheriffs and Civil Process Law; or (b) in other cases without the approval of the appropriate Local Government."

783 Section 22, Land Use Act provides: "It shall not be lawful for the holder of a statutory right of occupancy granted by the Governor to alienate his right of occupancy or any part thereof by assignment, mortgage, transfer of possession, sublease or otherwise howsoever without the consent of the Governor first had and obtained…"

784 Section 26 Land Use Act provides: "Any transaction or any instrument which purports to confer on or vest in any person any interest or right over land other than in accordance with the provisions of this Act shall be null and void". The Legislative antecedent of the provision of the Land Use Act on consent may be said to be the Land Tenure Law 1962 Cap 59, Laws of Northern Nigeria, 1963 revision and the Acquisition of Land by Aliens Edict, 1971, Laws of Lagos State. But, as pointed out by Ajala "…the requirement of consent and the failure to obtain such consent under the Land Tenure Law and Acquisition of Land by Aliens Law was not as far reaching in the effect as the provisions of the Act. This is so to the extent that the requirement of consent as stated above does not affect a transfer of an interest in land to a banking organization, a building society by way of mortgage". See T Ajala, 'Third Party Rights under the Land Use Act' in I O Smith (ed.), *Land Use Act Twenty Five Years After* (Faculty of Law University of Lagos, Lagos, 2003) 394-395.

(b) the benefit of all securities for the same and the benefit of and the right to sue on all covenants with the mortgagee, and the right to exercise all powers of the mortgagee; and

(c) all the estate and interest in the mortgaged property then vested in the mortgagee subject to redemption or cesser but as to such estate and interest subject to the right of redemption then subsisting.

Section 46(2) provides that transferee includes his personal representatives and assigns. The section also provides in subsection (3) that transfer of mortgage may be made in the form contained in the first schedule to the law with such variations and additions, if any, as the circumstances may require. The provision applies whether the mortgage transferred was made before or after the commencement of the Law. However, the section does not extend to a transfer of a bill of sale of chattels by way of security. The study recommends that the provision of section 46 of the LSMP Law be adopted by other states and submits that the provision will be useful in asset securitization.

6.2.6 Security by the SPV

The provisions of CAMA regarding debentures, debenture trust deed, debenture trustees, charges and registration of charges are relevant to security by the SPV in asset securitization transaction. A discussion of the relevant provision will therefore be undertaken in this segment of the study.

The relevance of trust deed in asset securitization transaction lies in the fact that the mechanism of the trust deed enables investors who are debenture holders to hold security by having legal interest vested in the trustees in trust for the beneficiary investors and the trustee can retain custody of title deeds in the case of legal mortgages.[785] Execution of debenture trust deed is relevant in asset securitization transaction because of issuance of securities to the public because execution of a trust deed is a mandatory prerequisite where a company offers debentures to the public for subscription or purchase. As a legal requirement, it is prescribed under the Investment and Securities Act that where the securities to be issued is debenture securities, the invitation must be accompanied with a trust deed.[786]

The SPV shall also procure the execution of the deed by the trustee for the debenture holders appointed by the deed.[787] It should be noted that a debenture trust deed shall not cover more than one class of debentures.[788] Where there is default in executing a trust deed when required, a debenture holder may make application and on the basis of that application the court may; order the company to execute a trust deed;[789] direct that a person nominated by the court shall be appointed to be trustee;[790] and give such consequential directions as it thinks fit, as to the contents of the trust deed and its execution by the trustee thereof.[791]

A debenture will be covered by a trust deed in either of two circumstances: one is where the holder of the debenture is entitled to participate in any money payable by the company under the deed[792] or two; where the holder of the debenture is entitled to the benefit of any

[785] See I O Smith, *Nigerian Law of Secured Credit* (n 1) 294.
[786] Section71(2) of the ISA.
[787] Section183(1) of CAMA.
[788] Section183(2) of CAMA.
[789] Section183(3)(a) of CAMA.
[790] Section183(3)(b) of CAMA.
[791] Section183(3)(c) of CAMA.
[792] Section 183(6)(a) of CAMA.

mortgage, charge or security created by the deed, whether alone or together with other persons.[793]

6.2.6.1 Contents of Debenture Trust Deed

The debenture trust deed in an asset securitization transaction must contain the following:

(a) the maximum sum which the company may raise by issuing debentures of the same class;

(b) the maximum discount which may be allowed on the issue or re-issue of the debentures, and the maximum premium at which the debentures may be made redeemable;

(c) the nature of any assets over which a mortgage, charge or security is created by the trust deed in favour of the trustee for the benefit of the debenture holders equally, and except where such a charge is a floating charge or a general floating charge, the identity of the assets subject to it;

(d) the nature of any assets over which a mortgage, charge or security has been or will be created in favour of any person other than the trustee for the benefit of the debenture holders equally, and except where such a charge is a floating charge or a general floating charge, the identity of the assets subject to it;

(e) whether the company has created or will create any mortgage, charge or security for the benefit of some, but not all, of the holders of debentures issued under the trust deed;

[793] Section 183(6)(b) of CAMA. The consequence for default in executing debenture trust deed when required or issuing debentures under a trust deed which covers two or more classes of debentures is that the directors of the company are guilty of an offence and liable on conviction to a fine of N5,000 jointly or severally- section183(7) of CAMA.

(f) any prohibition or restriction on the power of the company to issue debentures or to create mortgages, charges or any security on any of its assets ranking in priority to, or equally with the debentures issued under the trust deed;

(g) whether the company shall have power to acquire debentures issued under the trust deed before the date of their redemption and to re-issue the debentures;

(h) the rate of and the dates on which interest on the debentures issued under the trust deed shall be paid and the manner in which payment may be made;

(i) the date or dates on which the principal or the debentures issued under the trust deed shall be repaid, and unless the whole principal is to be repaid to all the debenture holders at the same time, the manner in which redemption shall be effected, whether by the payment of equal instalments of principal in respect of each debenture, or by the selection of debentures for redemption by the company, or by drawing, ballot, or otherwise;

(j) in the case of convertible debentures, the dates and terms on which the debentures may be converted into shares and the amounts which may be credited as paid up on those shares in right of the debentures held by them;

(k) the circumstances in which the debenture holders shall be entitled to realise any mortgage, charge or security invested in the trustee or any other person for their benefit (other than the circumstances in which they are entitled to do so by this Act;

(l) the powers of the company and the trustee to call meetings of the debenture holders and the rights of debenture holders to require the company or the trustee to call such meetings;

(m) whether the rights of debenture holders may be altered or abrogated and if so, the conditions which must be fulfilled, and the procedure which must be followed, to effect such an alteration or abrogation; and

(n) the amount or rate of remuneration to be paid to the trustee and the period for which it shall be paid, and whether it shall be paid in priority to the principal, interest and costs in respect of debentures issued under the trust deed.

The foregoing statements are also to be included in each debenture or in a note forming part of the same document or endorsed thereon where debentures are issued without a covering debenture trust deed being executed.[794] However, the inclusion of the statements will not be required if the debenture is the only debenture of the class to which it belongs which has been or may be issued, and the rights of the debenture holder may not be altered or abrogated without his consent.[795]

6.2.6.2 Contents of debenture covered by trust deed

By section 185 of CAMA every debenture covered by a debenture trust deed shall state, either in the body thereof or in a note forming part of the same document or endorsed thereon:

(a) the following matters required to be stated in a debenture trust deed:

(i) the maximum sum which the company may raise by issuing debentures of the same class; the maximum discount which may be allowed on the issue or re-

[794] Section 184(2) of CAMA.
[795] Section 184(3) of CAMA. Issuance of a debenture without complying with the provisions on insertion of the foregoing statements is an offence on the part of the director- section 184(4) of CAMA.

issue of the debentures, and the maximum premium at which the debentures may be made redeemable;

(ii) any prohibition or restriction on the power of the company to issue debentures or to create mortgages, charges or any security on any of its assets ranking in priority to, or equally with the debentures issued under the trust deed;

(iii) the rate of and the dates on which interest on the debentures issued under the trust deed shall be paid and the manner in which payment may be made;

(iv) the date or dates on which the principal or the debentures issued under the trust deed shall be repaid, and unless the whole principal is to be repaid to all the debenture holders at the same time, the manner in which redemption shall be effected, whether by the payment of equal instalments of principal in respect of each debenture, or by the selection of debentures for redemption by the company, or by drawing, ballot, or otherwise;

(v) in the case of convertible debentures, the dates and terms on which the debentures may be converted into shares and the amounts which may be credited as paid up on those shares in right of the debentures held by them; the powers of the company and the trustee to call meetings of the debenture holders and the rights of debenture holders to require the company or the trustee to call such meetings;

(vi) whether the rights of debenture holders may be altered or abrogated and if so, the conditions which must be fulfilled, and the procedure which must be followed, to effect such an alteration or abrogation;

(b) whether the trustee of the covering debenture trust deed holds the mortgages, charges and securities vested in him by the trust deed in trust for the debenture holders equally, or in trust for only some of the debenture holders, and if so, which debenture holders; and

(c) whether the debenture is secured by a general floating charge vested in the trustee of the covering debenture trust deed or in the debenture holders.

In the case of a naked debenture, it shall be stated on its face "in clearly legible print, that it is unsecured if no mortgage, charge or security is vested in the holder of the debenture or in any other person for his benefit as security for payment of principal or interest".[796]

6.2.6.3 Debenture Trustees

Whether secured or unsecured by a charge, a debenture may be secured by a trust deed under which trustees will be appointed for the debenture holders.[797] Where there are charges securing the debenture, the charges may be created in favour of the debenture holders by vesting them in the trustees.[798]

The duty of the trustees shall be to safeguard the rights of the debenture holders and, on behalf of and for the benefit of the debenture holders, to exercise the rights, powers and discretions conferred upon them by the trust deed.[799]

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[796] Section185(2) of CAMA.
[797] Section186(1) of CAMA.
[798] Section 186(3) of CAMA.
[799] Section 186(2) of CAMA.

In order to safeguard the debenture holders and ensure transparency and diligence on the part of the trustees, there is express prohibition of exemption clause exempting a trustee from, or indemnifying him against, liability for any breach of trust or failure to show the degree of care and diligence required of him as trustee having regard to the powers, authorities or discretions conferred on him by the trust deed.[800] It is, however, provided that the prohibition on the aforesaid exemption clause would not invalidate any release otherwise validly given in respect of anything done or omitted to be done by a trustee on the agreement to such release of a majority of not less than three quarters in value of the debenture holders present in person, or where proxies are permitted, by proxy at a meeting summoned for the purpose.[801] The court may remove a trustee and appoint another one where there is possibility of conflict of interest.[802]

The following persons are not entitled to be a trustee:[803]

i. an officer or an employee of the company which issues debentures covered by the trust deed or of a company in the same group of companies as the company so issuing debentures;

ii. a person less than 18 years of age;

iii. a person of unsound mind and has been so found by a court in Nigeria or elsewhere;

iv. an undischarged bankrupt;

v. disqualified under section 257 of this Act from being appointed as a director of a company;

[800] Section 186(4) of CAMA.
[801] Proviso to section 186(4) of CAMA.
[802] Section 186(5) of CAMA.
[803] Section 187(1) of CAMA.

vi. a substantial shareholder (as defined in section 95 of this Act) of the company

6.2.6.4 Register of Debenture Holders

There is requirement for maintenance of register of debenture holders and the register shall contain the following:[804]

i. the names and addresses of the debenture holders;

ii. the principal of the debentures held by each of them;

iii. the amount or the highest amount of any premium payable on redemption of the debentures;

iv. the issue price of the debenture and the amount paid up on the issue price;

v. the date on which the name of each person was entered on the register as a debenture holder; and

vi. the date on which each person ceased to be a debenture holder.

6.2.7 Charges Securing Debentures

A debenture may be naked or a secured debenture; a secured debenture is one in respect of which some security is created over the assets/property of the company. Charges are a veritable means over which security is created in a debenture as regards the underlying indebtedness. Section 567 of CAMA did not define a charge. There are however two kinds of charge that may be created under CAMA, that is fixed charge or floating charge.[805]

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[804] Section 193(1) and (2) of CAMA.

[805] Section 178 CAMA; The definition of what constitute floating and fixed charges is fraught with difficulties and has been subject matter of judicial and academic debates; See, *National Westminster Bank Plc v. Spectrum Plus Limited* [2005] UKHL 41, [2005] 2 AC 680 available online at http://www.bailii.org/uk/cases/UKHL/2005/41.html last visited on 29

Even though, the heading of section 178 of CAMA is "Meaning of "floating" and "fixed" charges, the section did not define or describe a fixed charge. Rather, the section defines floating charge as an equitable charge over the whole or a specified part of the company's undertakings and assets, including cash and uncalled capital of the company both present and future, but so that the charge shall not preclude the company from dealing with such assets until the security becomes enforceable and the holder thereof, pursuant to a power in that behalf in the debenture or the deed securing the same, appoints a receiver or manager or enters into possession of such assets; or the court appoints a receiver or manager of such assets on the application of the holder; or the company goes into liquidation.

Registration or filing is a mode of perfecting some types of security interest. Even though the terms are at times used interchangeably, it has been observed that there is distinction between registration and filing because "it is more accurate to speak of registration as the lodgement of particulars relating to the security, and filing as the lodgement of the security instrument itself or a copy of it".[806]

It has been said that the public registration of security interests is designed to overcome the twin evils of 'false wealth' and 'secret liens'.[807] As regards purpose of registration, Alli has submitted that:

> Public registration supplies notice of the security interest to present and prospective creditors, thus preventing the security provider- particularly where

May, 2008; J Getzler and J Payne, *Company Charges: Spectrum and Beyond* (Oxford University Press, Oxford, 2006): O Ajayi (n 376). However, a discussion of the juridical nature of company charges is not within the purview of this study.

[806] R M Goode, *Commercial Law* (n 190) 649-650.

[807] P A U Alli, The Law of Secured Finance (n 188) 134. These policy grounds were examined and enunciated as early as 20th century in the following cases: *Re Jackson and Bassford Ltd* [1906] 2 Ch.D467; *Re Yolland, Husson Birkett Ltd* [1908] 1 Ch.D 152; *Esberger & Sons Ltd v Capital and Counties Bank* [1913] 2 Ch.D 366; *Dublin City Distillery Ltd v. Doherty* [1914] AC 832.

> the security provider retains possession of the secured property following the grant of a security interest- from holding itself out as the unencumbered owner of the secured property, and consequently raising additional credit on that basis, as well as preserving the expectation of the above creditors as to the priority of their claims against the security provider.[808]

Basically, the mode of perfection of security interests in company charges is by way of registration under CAMA. The registration provision under the Nigerian law, like the corpus of Nigerian company law has its ancestry in English Company Law.[809]

The registration of charges with the Registrar of Companies began on 1 January 1901[810] and it has been said, as regards England, that the introduction of the register of charges which may be inspected by anyone "was a great improvement in protection for creditors".[811] The law relating to registration of charges is of real importance to the capital market as it guards against fraud and facilitates commercial borrowing.[812]

A Company is required to keep copies of instruments creating charges[813] as well as register of charges.[814] A company is also required to keep register of debenture holders[815] which register shall contain certain specified information.[816] These provisions, however, do not impact on

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808 P A U Alli, *The Law of Secured Finance* (n 188) 134 -135. See also, R M Goode, 'The Modernisation of Personal Property Security Law' (1984) 100 LQR 238-9.

809 See O Orojo, *Company Law and Practice in Nigeria* (3rd edn. Mbeyi & Associates, Lagos 1992) 16.

810 D French, S Mayson and C Ryan (n 384) "CA 1862 had required each limited company to keep at its registered office a register of charges on its own property. However, only members of the company and existing creditors had a right to inspect this register, and if a charge was not entered in the register, it did not become ineffective in any way (*Wright v. Horton* (1887) 12 App Cas 371) though fines could be imposed on company officers for failure to register"

811 D French, S Mayson and C Ryan, (n 384) 311.

812 McCormack (n 387) 129.

813 Section 190 CAMA.

814 Section 191 CAMA.

815 Section 193(1) CAMA

816 Section 193(2) CAMA, that is, - (a) the names and addresses of the debenture holders; (b) the principal of the debentures held each of them; (c) the amount or the highest amount of any premium payable on redemption of the debentures; (d) the issue price of the debenture and the amount paid up on the issue price; (e) the date on which the name of each person was entered on the register as a debenture holder; and (f) the date on which each person ceased to be a debenture holder.

perfection/registration of security interests that have been created by a company in favour of a secured party.

Section 197(1) of CAMA provides that where a company creates on its property any of the charges specified in that section, the company must, within ninety days of the creation, deliver to the Commission for registration certain prescribed particulars of the charges.[817]

Section 197(2) of CAMA provides that the provisions on registration in section 197 shall apply to the following charges, that is

(a) a charge for the purpose of securing any issue of debentures;

(b) a charge on uncalled share capital of the company;

(c) a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;

(d) a charge on land, wherever situate, or any interest therein, but not including a charge for rent or other periodical sum issuing out of land;

(e) a charge on book debts of the company;

(f) a floating charge on the undertaking or property of the company;

(g) a charge on calls made but not paid;

(h) a charge on a ship or aircraft or any share in a ship; and

(i) a charge on goodwill, on a patent or a license under a patent, on trademark or on a copyright or a licence under a copyright.

[817] J O Orojo, *Company Law and Practice* (n 380) 209-210.

The following are required to be delivered to the Commission for the purpose of registration, that is, the prescribed particulars of the charge; and the instrument, if any, by which the charge is created or evidenced.[818]

In interpreting section 197(3) of CAMA Orojo[819] has stated that:

> Where a charge affects or relates to property situated in Nigeria, and in addition to registration under section 197(1), registration elsewhere in Nigeria is necessary to make the charge valid and effectual (for example under the Land Use Act, 1978), it is sufficient if, instead of the original, a certified true copy is delivered to the Commission.

With respect, the reference to the Land Use Act is not apposite as the Land Use Act does not contain provision on registration of property/land even though it preserves all existing laws relating to the registration of title to, or interest in, land[820]. The applicable provision to registration of Land is Land Instrument Registration Law[821] or Lagos State Lands Registration Law 2015 whichever is applicable.

Where a company registered in Nigeria creates a charge on property situated outside Nigeria the delivery to and receipt by the Commission of a copy of the instrument verified in the prescribed manner is sufficient compliance with section 197(1), provided it is delivered within ninety days after the date on which the instrument or copy could, in due course of post and if dispatched with diligence, have been received in Nigeria.[822]

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[818] Section 197(1) CAMA; J O Orojo, *Company Law and Practice* (n 380) 210.
[819] J O Orojo, *Company Law and Practice* (n 380) 210.
[820] Subject to such modifications (whether by way of addition, alteration or omission) as will bring those laws into conformity with the Act or its general intendment- section 48, Land Use Act, Cap L60, Laws of Lagos State, 2003.
[821] For example, Cap 64, Laws of Osun State, 2000, section 14.
[822] Section 197(5) CAMA.

Furthermore, where the charge is created in Nigeria but affects or relates to property situated outside, the instrument may be sent for registration notwithstanding that further proceedings may be necessary to make the charge valid under the law of the country in which the property is situated.[823] It is also pertinent to note that where a negotiable instrument has been given to secure the payment of any book debts of a company, the deposit of the instrument for the purpose of securing an advance to the company will not be treated as a charge on those book debts[824].

There is provision for issuance of certificate by the Commission consequent upon the registration of the charge. The certificate of the registration shall contain the following[825]: the parties to the charge; the amount secured; and other necessary particulars. The certificate shall be *prima facie* evidence of due compliance with the requirements as to registration under the Act.[826]

The law places the obligation to register the particulars on the company but registration may be effected on the application of any person interested in the charge, and that person is entitled to recover from the company the amount of the fees which he properly paid for the registration[827]. In view of the fact that lack of registration may adversely affect the secured party, such secured party in practice takes it upon himself to carry out the registration.

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[823] Section 197(6) CAMA; J O Orojo, *Company Law and Practice* (n 380).
[824] Section 197(6) CAMA; J O Orojo, *Company Law and Practice* (n 380) 210.
[825] Section 198(2) CAMA.
[826] ibid.
[827] ibid.

It may be noted that unless the registration has been effected on the application of some other person, the company and every officer of the company who is in default shall be guilty of an offence and liable to a fine of ₦500.[828] There is no doubt that this penalty is grossly inadequate and would not, by itself compel anybody to comply with the registration provision. It is suggested that the penalty be made a certain percentage of the sum of the relevant transaction, for example 2.5 per cent so that the provision will be compelling. Furthermore, provision on registration as the determining factor for priority will also provide compelling reason for prompt registration.

The civil sanction for failure to register a registrable charge as required is that the charge will be rendered void against the liquidator and any creditor of the company.[829] This, however, will not affect obligation of the company to pay the debt as "the money thereby secured shall immediately become payable".[830]

One of the issues that may arise in the context of mandatory provision on registration of charges and its effect is that of a possibility of re-characterization of assignment or transfer of the receivables to the SPV as a charge and not an assignment or true sale. For constraints of space, this issue will be discussed in an elaborate manner in the next chapter on legal risks in asset securitization.

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[828] Section 199(3).
[829] Section 197 CAMA.
[830] *Fasakin v. Fasakin* [1994] 4 NWLR (Pt. 340) 597, 616 (Uwaifo JCA); *Capital Finance Co Ltd v. Stokes* [1969] 1 Ch.D 261.

6.2.8 Issuance of Securities by the SPV to the Public

The SPV will get the funds to pay for the asset transferred to it by the originator by issuing and selling securities in the capital market. This is another aspect of securitizations that has legal and regulatory dimensions as the relevant legal and regulatory framework for public issue of securities comes into play.[831] The relevant provisions are contained in the Investment and Securities Act, 2007, [832] Securities and Exchange Commission (SEC) Rules and Regulations and Nigerian Stock Exchange Listing Requirements.

As earlier noted, the SPV must be structured as a public company to be able to offer securities to the investing public.[833] The security to be issued by the SPV must be registered with the Securities and Exchange Commission before issuance of same to the public.[834] Section 54(2) of the ISA also provides for the filing of a registration statement with the Securities and Exchange Commission. This registration statement shall be signed by the issuer, its chief executive officer or officers, its principal financial officer and every person named as member of the board of directors or persons performing similar functions. If the issuer is a foreigner then such statement must be signed by its duly authorized representative in Nigeria. The statement filed is deemed effective only to the securities or investments specified therein as

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[831] For a general and useful treatise on companies securities in Nigeria, see J E O Abugu, *Companies Securities: Law and Practice* (2nd edn, MIJ Professional Publishers Ltd, Lagos, 2014).

[832] Cap I Laws of the Federation of Nigeria, 2010. Hereinafter referred to as the ISA.

[833] See section 67(1)(a & b) of the ISA. Securities is defined by section 315 of the ISA to mean:

"Debentures, stocks or bonds issued or proposed to be issued by a government; Debenture, stock, shares, bonds or notes issued or proposed to be issued by a body corporate; Any right or option in respect of any such debenture stocks, share, bonds or notes; or Commodities futures, contracts, options and other derivatives, and the term securities in this Act includes those securities in the category of the securities listed in (a)-(b) above which may be transferred by means of any electronic mode approved by the Commission and which may be deposited, kept or stored with any licensed depository or custodian company as provided under this Act".

[834] Section 54(1) of the ISA.

proposed to be issued[835] and upon filing the Commission shall issue a certificate of registration in respect of securities and investments registered by it.[836] The provision of section 54(6) and (7) of the ISA provides for the fine/punishment for contravention of the registration requirement.

Before registration of the Asset Backed Securities, the SPV should have taken some prior steps. The steps include but are not limited to the provision of section 60 of the ISA. While section 60(1) provides for the filing of annual and periodic reports with the Securities and Exchange Commission section 60(2)(a-f) provides for the form and contents of such report as well as the officers responsible for each report. To ensure the correctness of the reports required for filing by the commission section 61(1) of the ISA[837] provides that:

> "A public company shall establish a system of internal controls over its financial reporting and security of its assets and it shall be the responsibility of the board of directors to ensure the integrity of the company's financial controls and reporting."

The above is to ensure that a system of internal control exist in such company and the provision of section 61(2) of the ISA places the burden of ensuring that on the board of directors as they are required by the provision[838] to insert in their annual report the effectiveness of such mechanism.

While section 64 of the ISA provides that a listed public company shall within 20 working days prior to the commencement of a quarter disclose to the relevant securities exchange its quarterly earnings forecast, section 62 provides for the requirement of registration of auditors

[835] Section 54(3) ISA.
[836] Section 54(4) ISA.
[837] Investment and Securities Act.
[838] Section 61(2) of the ISA.

of a public company with the commission[839] and section 63 provides for the duties of such auditors. Section 65(1) and (2) provides for the penalties for contravention of sections 60 - 64.

By section 8(1) of the ISA, the SPV must obtain written consent of the commission before issuing its securities and the invitation to the public must be done in accordance with such conditions and restrictions as may be imposed by the Securities and Exchange Commission. The Securities and Exchange Commission has an absolute discretion to either grant or withhold such consent and impose such other requirement as evidenced from the provision of section 68(2). Section 68(3) makes any untrue statement in the invitation an offence and makes the director(s) of the company and anybody responsible for such untrue statement liable, however such liability can be absolve if the director or officers can make an explanation in line with the provision of section 68(4).

The ISA having made any untrue statement in an invitation an offence as well as placing the liability on officer responsible or the director(s) also provide a reprieve for any investor who either innocently or fraudulently subscribed to such offer as a result of the untrue statement by making it possible for such investor to recover his money with interest at the current bank rate or such higher rate as may have been agreed to be paid on the deposit.[840]

Generally, the form of application to the public for the acquisition of securities issued by the SPV must be accompanied by a prospectus which complies with the requirements of section 79 of this Act.[841] Because the securities to be issued by the SPV will be debenture securities,

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[839] Security and Exchange Commission

[840] See section 68(5) of the ISA.

[841] Section 71(1) of the ISA.

the invitation must be accompanied with a trust deed.[842] Even though section 71(3) created exemptions to the mandatory requirements for a prospectus, the exemptions are not really applicable in asset securitization transaction.[843]

Further, the SPV may be exempted from the legal requirement of issuance and form of prospectus where the transaction relates to "issue of a prospectus or forms of applicant relating to securities which are to be in all respects uniform with securities previously issued and for the time being dealt in or quoted on a securities exchange or capital trade point".[844] To reduce issue cost, however, it may be necessary to obtain exemption from compliance with full prospectus requirements from the Nigerian Stock Exchange or a capital trade point under section 76 of the ISA.

It is important that care must be exercised that statements contained in the prospectus or statement in lieu of prospectus be true and correct. There are ample provisions under the ISA for liability and persons liable for false or untrue statement in a prospectus. There appears to be a wide meaning of a statement included in a prospectus. Section 83 of the ISA provides that a statement included in a prospectus shall be deemed to be untrue if it is misleading in the form and context in which it is included; and the statement shall be deemed to be included in a prospectus if it is contained in the prospectus or in any report or memorandum appearing on the face of it or by reference incorporated or issued with it.

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[842] Section 71(2) of the ISA.
[843] See generally, sections 72, 73, 77, 78, 80,81, 82, 83, 85 and 86 of the ISA on relevant provision on prospectus.
[844] Section 74(b) of the ISA.

While section 85(1) of the ISA provides for the civil liability of persons listed in section 82(2) for any untrue statement in a prospectus, sections 86 and 87 provides for the criminal liability of those officers for any untrue statement in a prospectus and statement in lieu of prospectus respectively. Notwithstanding the provisions for civil and criminal liability of the company, its directors and officers or Experts for an untrue statement in a prospectus or statement in lieu of prospectus, the subscriber or shareholder can also bring an action for rescission as provided in section 94. It is thus imperative that the relevant professionals engaged by the SPV as well as the officers of the SPV cannot be too careful in ensuring the accuracy and integrity of the information and data to be included in the prospectus.

6.2.9 Rating Agencies

Rating agencies play very vital role in asset securitization.[845] The asset-backed securities to be offered by the SPV will have to be reviewed by credit rating agencies. The analyses that will be conducted will include extensive analyses of bad-debts experiences, cash flow certainties, and rates of default. After the analyses, the agencies will then rate the securities. As pointed out earlier in this study, one of the attractions of asset securitization is that the transaction avails a company to have access to funding upon a higher rating of the SPV than that of the originator. In order to enhance the quality of securitized receivables and obtain higher ratings, the rating agencies may also suggest some forms of credit enhancement that has to be packaged with the securitized assets. The rating agency will advise the originator company on how the transaction must be structured in order to obtain a specific rating for each security

[845] J V Robbe (n 11) 45-6.

and in this behalf the issuer will be told how much credit enhancement is required in the structure in order to achieve a specific credit rating for each bond class.[846]

The importance of rating agencies and their rating of securities can be seen from the fact that, as a matter of regulation, certain investors or investment may only be carried out where the securities or transaction meets a stipulated rating threshold. For instance, under the Regulation on Investment of Pension Fund Assets[847] stipulate rating requirements for the kinds of investment in which pension fund assets may be invested.[848] Relevant to asset securitization specifically is that mortgage backed securities or asset-backed securities in which Pension Fund Assets are invested must have a minimum investment grade level rating of **"BBB"** by, at least, one recognized Risk Rating Company.[849]

Under the ISA, a rating agency must be registered with the Securities and Exchange Commission which is empowered to register and regulate credit rating agencies.[850] Provisions for registration of rating agency are contained in Securities and Exchange Commission Rules and Regulations.[851] A rating agency shall be a private or public limited company incorporated in Nigeria under CAMA.[852] Where a rating agency in Nigeria is affiliated to a foreign rating company, it shall supply the following information: evidence of registration of such company

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846 F J Fabozzi and V Kothari (n 11). The commentator noted that the "higher the credit rating sought by the originator company, the more credit enhancement a rating agency will require for a given collateral".

847 Available at http://www.pencom.gov.ng/docs/1448884100_Regulation_on_Investment_of_Pension_Assets_2012.pdf; last visited on 6th December, 2015.

848 See Paragraph 4.3 of the Regulation on Investment of Pension Assets op cit.

849 This is by a combined reading of paragraphs 5.1 and 5.1.3 of the Regulation on Investment of Pension Fund Assets, op cit.

850 Section 13(m) of the ISA.

851 Rule 38 of the Securities and Exchange Commission Rules and Regulation. See Regulation 38(3) for registration requirements.

852 Rule 38(1). The registered rating agencies in Nigeria are: Agusto and Co.; Brickfield Road Associates Limited; Datapro Limited; Global Credit Rating; and Pharez Limited.

in the foreign country; profile of the foreign company and principal officers; audited accounts of the foreign company; affiliation agreement between the Nigerian company and the foreign company. It is submitted that the recognition of a Nigerian rating agency with a foreign rating company is commendable as it is capable of integrating the rating system in Nigeria within the context of the global business.

Of particular import in the context of the role of rating agencies has to do with whether rating agencies are rendering professional advice or rendering an opinion. By rule 38(7) of the Securities and Exchange Commission Rules and Regulations, a rating agency must make a declaration that "rating is an opinion and not a professional investment advice". The practical implication of this declaration would be that the rating agencies may not be liable to investors for relying on the rating of the agencies. It is debatable whether this position is satisfactory from the point of view of the investors who may contend that rating agencies are handsomely paid for their services and that they were very much aware of the reliance placed on their ratings by groups of investors.[853] In view of the role played by the rating agencies in the recent global financial crisis, particularly as regards the rating of asset backed securities, it is submitted that the existing law on rating agencies needs reform with a view to promoting asset securitization in Nigeria.

6.3 Constitutional Competence to Legislate on Asset Securitization

As has been seen from the foregoing discourse and will be clearer in the discussion on legal risks in asset securitization in the next chapter, structuring asset securitization under the

[853] See J V Robbe (n 11) 46.

existing law is fraught with challenges evidencing inadequacies of using the existing law not specifically enacted with the peculiar challenges of asset securitization in view. Therefore, making it imperative to advocate specific provisions on asset securitization just like in many countries where asset securitization has been embraced and specific legislations have been made to facilitate asset securitization and address the peculiar legal challenges of asset securitization.

Enacting legislation on asset securitization in Nigeria will have to contend with the issue of operation of a federal constitution in Nigeria because the applicable legal provisions in structuring asset securitization straddle legislative competence of the federal and state governments.

The Nigerian Constitution provides that Nigeria shall be a federation consisting of a central or federal government, states and Federal Capital Territory.[854] The position of the Nigerian law, in view of the decision of the Supreme Court in *Olafisoye v. FRN,*[855] is that legal determination of the competence of any level of government in Nigeria will require recourse to the provisions of the Constitution and not to any abstract theories or general definitions.

As earlier stated, asset securitization, as an aspect of structured finance, has its own peculiar characteristics and challenges and in promoting asset securitization in Nigeria today, reliance will have to be placed on the general property law and some corporate and securities legislations earlier dwelt upon in this chapter.

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[854] Section 2(2) 1999 Constitution. *Attorney General of Ondo State v. Attorney General of the Federation* [2002] 9 NWLR (Pt. 772) 222 at 377-378, paras F-A; *Olafisoye v. F.R.N*. [2004] 4 NWLR (Pt. 864) 580 at 647.

[855] [2004] 4 NWLR (Pt. 864) 580.

Different legal provisions and multiplicity of laws are applicable to carry out the different aspects of the structure of the transaction. On the one hand, for the transfer of the assets or receivables to the SPV, the applicable provisions will be Conveyancing Act,[856] Property and Conveyancing Law,[857] Property Law,[858] Nigerian case-law, rules of common law and doctrines of equity on assignment and novation of proprietary interest particularly chose in action which are matters within the legislative competence of the state. On the other hand, reliance will have to be placed on some laws within the legislative competence of the federal government such as the provisions of CAMA[859] in setting up of the SPV as well as the creation of debenture by the SPV, the creation and registration of charges, the making of the Security Trust by the SPV and the appointment and regulation of the activities of the security trustee. Also, the provisions of the Investment and Securities Act[860] will also be applicable for the registration of the security to be issued by the SPV, the exercise of regulatory controls by the Securities and Exchange Commission, issuance of the securities by the SPV and registration and regulation of the credit rating agencies.

The provisions of the Land Use Act[861] will also be applicable in the assignment of security underlining the receivables to the SPV where land or landed property is involved. The legal provisions on perfection, priority and enforcement of security interests including, Land Instrument Registration Law and Stamp Duties Act will come into play. The Listing

[856] In states where no general property legislation has not been made and reliance is still placed on the English Conveyancing Act as a Statute of General Application.
[857] Applicable in Ogun, Ondo, Oyo, Osun, Ekiti, Edo and Delta States. The provision of these laws are identical and based on the Property and Conveyancing Law, Cap 100, Laws of Western Nigeria, 1959. See for example, Property and Conveyancing Law, Cap 132, Laws of Osun State.
[858] Cap P10 Laws of Kwara State, 2006, applicable in Kwara State.
[859] Cap C20, Laws of the Federation of Nigeria, 2010.
[860] Cap I24 Laws of the Federation of Nigeria, 2010.
[861] Cap L5, Laws of the Federation of Nigeria, 2010.

Requirements of the Nigerian Stock Exchange will also be applicable for the trading of the security created by the SPV at the floor of the exchange.

Therefore, the existing applicable laws to asset securitization straddle the legislative competence of both the Federal and State Governments. Therefore, a real theoretical and practical issue arises as to which, as between the federal and state governments, will have the competence to make law on securitization when needed.

One possible contention will be that in view of the fact that asset securitization is not mentioned in the Exclusive Legislative List and Concurrent Legislative List, then asset securitization is residual legislative item within the competence of the state legislature.[862]

A contrary contention may be that even though asset securitization is not expressly mentioned in the legislative list, the federal government may legislate on asset securitization by relying on either or both of item 12 of exclusive legislative list on "Control of capital issues" and item 32 of exclusive legislative list on "Incorporation, regulation and winding up of bodies corporate, other than co-operative societies, local government councils and bodies corporate established directly by any law enacted by a House of Assembly of a State". The argument will be that asset securitization, is essentially, about setting up of an SPV as a separate entity and issuance of asset-backed securities by the SPV and these are covered by items 12 and 32 of the Exclusive Legislative List.

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[862] This contention may be predicated on the provisions of section 4(7) of the 1999 Constitution and the decision of the Supreme Court in *Attorney General of Lagos State v. Attorney General of the Federation* (2003) 12 NWLR (Pt. 833) 1.

This argument, while true in part, is not totally true. This is because an important aspect of asset securitization has to do with transfer of the receivables and the underlying security by the originator to the SPV which essentially is governed by general law on assignment of receivables which are state laws within the competence of the state government. Therefore, any attempt by the federal government to include provisions on assignment or transfer of receivables may be challenged as usurpation of matters within the legislative competence of the state government.

As will be seen in Chapter Seven, the transfer of receivables to the SPV and the attendant problem of re-characterization are critical areas requiring legislative intervention. In this regard, therefore, it may be suggested that, if the existing constitutional delineation of legislative power is applied, then two sets of laws may have to be made on asset securitization relative to which area that the federal and state governments may legislate upon in respect of the different aspects of asset securitization transaction. This solution itself may be said to be untidy and the thesis therefore advocates for a constitutional change to make asset securitization a distinct subject matter of legislation within the legislative competence of the federal government. This will allow for making of a comprehensive composite legislation on asset securitization and ensure uniformity of legal provisions on asset securitization throughout the country.

6.4 Summary

This chapter considers the legal frameworks for structuring asset securitization under the existing law and legislative competence to enact law on asset securitization. The study highlights the basic process or structure of asset securitization and discusses the legal issues surrounding different aspects of its structure.

On securitizable assets/receivables, the study finds that, in asset securitization, it is the receivables and not the loans that are securitised. The study submits that there is legal significance in making the distinction because the transfer of the whole loans requires the consent of the borrower but the assignment of the receivables can be effected without such consent so long as there is notification which may even be delayed.

The study finds that some of the traditional criteria for accepting an asset as being securitizable are: the asset should give rise to cash flows over a period of time and the cash flows should be steady and easy to identify; the receivable being securitized must be of high quality; the portfolio should be diversified such that no individual asset should have a significant value relative to the size of the portfolio.

The study examines the issue of possibility or otherwise of assignment of future, potential and contingent chose in action and submits that while it may be undisputable that present, future and potential receivables can be assigned, there may be some controversies as to whether a contingent right can be assigned. The study further submits that the present state of the law has gone beyond the issue of un-assignability of future, potential and contingent receivables but that it may be safe to submit that, in the context of securitization, future, potential and contingent receivables may not be securitizable assets as the receivables may not yield to cash flows that is steady and easy to identify.

The study finds that the SPV serves as intermediary between the originator and investors and that it is by the means of the SPV that the dual objectives of transferring assets to the investors and at the same time creating a capital market instrument are achieved. In terms, of formation, since the SPV will usually issue its securities to the public, the study submits that the SPV should be formed as a public limited company. Further, that the SPV must fulfil its obligations under the law

It is submitted that a fundamental objective in structuring of the SPV is to attain bankruptcy remoteness, that is, that the possibility of the SPV becoming bankrupt or insolvent should be remote and that the whole essence of securitization will be defeated if the SPV can easily become bankrupt or insolvent. The study submits that bankruptcy remoteness is achieved by the following mechanisms; isolating the ownership and control of the SPV from the originator; restricting the business dealings of the SPV; imposing certain restrictions on the purchaser of the notes; and by reducing if not eliminating the risk of claw-back by an insolvency officer if the SPV in any event become insolvent. The study further finds that these mechanisms dictate certain features that the SPV must have from the legal perspective with a view to safeguarding the interests of the investors.

The study also considers limited recourse clause and its practical implication and submits that a clause prohibiting right to petition for winding up may not be enforceable under Nigerian law because the right to petition for winding up is statutory and under stipulated circumstances. The chapter also discusses legal and practical issues relating to transfer of assets/receivables to the SPV. The study submits that care must be taken that the transfer of the assets is legally binding and that the transfer is regarded in law as a true sale so as to avoid the risk of re-characterization and the attendant consequences

It is found that the issue of pricing is important and that, usually, the receivables may be sold at a discount with a view to reflecting that some of the receivables will be uncollectable and the financing cost to the SPV for funding the purchase. Also, the study finds that assignment is the usual means by which the assets/receivables are transferred to the SPV. The study submits that the legal aspects of assignments of receivables under Nigerian law still reflects the dichotomy between law and equity as handed down by the received English law and that assignment can be legal or statutory, or equitable. It is found that based on the statutory provisions, the following are necessary to create valid legal assignment: the assignment must be in writing under the hand of the assignor and must be of a ‘debt or other legal things in action’; the assignment must be absolute; and the assignment must not purport to be by way of charge only. The study finds that the court would take a liberal approach in finding that there is an assignment from the relevant instrument.

Having examined the legal ramifications of legal assignment, the study finds that there are some challenges with regard to use of legal assignment in securitization transaction and that due to these challenges of legal assignment, equitable assignments are resorted to. The study, however, submits that there are also some risks associated with adoption of equitable assignment. In the context of assignment of legal or equitable chose in action, the study finds that equity did not follow the common law as equity have always recognised and enforced assignments of all chose in action. Therefore, for an equitable assignment to be valid, the assignment must be communicated to the assignee.

The study finds that whether consideration is required to support an equitable assignment or not would depend on the type of property being assigned as well as the form of the assignment. The study however submits that in view of this and the fact that hardly will the originator raise the issue of lack of consideration against the SPV coupled with the fact that, in the context of asset securitization, there will almost always be consideration for the transfer of the assets or receivables by the originator to the SPV, no useful purpose is served by analysing the relevant situations whether consideration is necessary or not in the study. It is further submitted that the practical implication of the general rule that an assignee takes subject to equities irrespective of whether the assignment is legal or equitable is that receivables that are susceptible to rights of set-off and counterclaim may be negatively impacted.

The chapter also considers the issue of assignability of the receivables in the context of the transfer of the receivables to the SPV. The study submits that in resorting to assignment as a means of transfer of the receivable, it is important to properly scrutinise the underlying contracts and determine whether there is express prohibition on assignment because, as a matter of law, an assignment contravening an express prohibition on assignments is void irrespective of whether the assignee was aware of the restriction. The study however further submits that the courts construe restrictions on transfer narrowly since the law prefers the free marketability of property.

The study also finds that there are situations where the consent of the debtors is needed for the valid assignment of the receivables due to various reasons and that this may well be impossible or difficult from practical point of view. As a result of the problem of assignability, the study submits that alternatives to assignment might include a trust of the receivables, a trust of proceeds, sub-participations or a novation. Furthermore, the study recommends that an alternative for overcoming the problem of restriction of assignment is by enacting laws which override restriction on assignments with a view to improving the marketability of claim but that this legislative intervention may be said to be at the expense of freedom of contract. Examples of legislative intervention in the United State, France and Germany were set out in the study.

The chapter further considers legal issues as regards transfer of security interests supporting the assets or receivables to the SPV. The study submits that the transfer is usually by way of assignment and that the assignment of the security interests is required because the SPV cannot enforce the underlying security where there was no valid assignment and registration of the security interest in favour of the SPV.

The study submits that, in Nigeria, where the security is a mortgage over land, consent of the local government or the governor is mandatory. The study, therefore, submits that the continuous insistence on compliance with the consent provision to security transaction with its attendant problem of high cost of procurement of consent and length of time involved aside other bureaucratic hold ups, remains a serious problem to secured transactions under

Nigerian law and that this problem of consent will also negatively impact on the use of securitization in Nigeria.

The study finds that in Lagos State, transfer of underlying security in asset securitization, where the security is mortgage, will benefit from section 46 of the LSMP Law. The study recommends that other states should adopt the provision.

The study submits that trust deed is relevant in securitization for two reasons: one, the mechanism of the trust deed enables the investors who are debenture holders to hold security by having legal interest vested in the trustees in trust for the beneficiary investors and the trustee can retain custody of title deeds in the case of legal mortgages; two, the Investment and Securities Act, 2007 provides that where the security to be issued is debenture securities, the invitation must be accompanied with a trust deed

It is found that whether secured or unsecured by a charge, a debenture may be secured by a trust deed under which trustees will be appointed for the debenture holders and that where there are charges securing the debenture, they may be created in favour of the debenture holders by vesting them in the trustees.

The study submits that one of the issues that may arise in the context of mandatory provision on registration of charges and its effects is that of a possibility of re-characterization of assignment or transfer of the receivables to the SPV as a charge and not an assignment or true sale and this may have negative consequences in the case of insolvency of the originator. The study also examines legal aspects of issuance of securities by the SPV to the public. In this regard, the relevant provisions are contained in the Investment and Securities Act, 2007, Securities and Exchange Commission (SEC) Rules and Regulations and Nigerian Stock Exchange Listing Requirements.

The study recommends that the SPV must be structured as a public company to be able to offer securities to the investing public and that the security to be issued by the SPV must be registered with the SEC. The study further submits that to reduce issue cost, exemption may be obtained from compliance with full prospectus requirements from the Nigerian Stock Exchange or a capital trade point under section 76 of the ISA.

The chapter examines the vital role played by rating agencies in securitization transaction and submits that the recognition of a Nigerian rating agency with a foreign rating company is commendable as it is capable of integrating the rating system in Nigeria within the context of the global business.

Even though, there are many aspects of Nigerian law applicable to securitization transaction, the study finds that there is no specific law that addresses the peculiarities of securitization transaction. The study recommends that there is need for specific law on securitization transaction. It also recommends that there may be a need to change tax and capital market laws, so the full benefits of asset securitization can be obtained. It is further recommended that the legislative effort should also address the rules on equitable assignments and registration of charges by SPV. Another recommendation is that stamp duties will have to be minimized, if not exempted, and VAT should not be payable upon the purchase of the receivables. In addition, the return on the investments by investors should not be taxable, (neither should the SPV withhold tax before distribution). It is submitted that, in this way, cost and expense of securitization will be significantly reduced, while returns are enhanced.

The study also recommends that the Central Bank of Nigeria should make relevant rules aimed at providing banks with certainty as to the rules on asset securitization for the purpose of recognition of the accounting and financial treatment of the structured financing. It is further recommended that the rules on capital adequacy and lending limits, should recognize asset securitization, as a means of complying with these rules. The study further recommends that the SEC should come up with clear and specific rules on asset securitization transaction so that it is not turned into an instrument of fraud or other financial and money market crime with attendant devastating effect on investors' confidence and the financial system.

Further recommendation is that market operators should, as a measure of self regulation, make market led rules on asset securitization, particularly on the transfer of rights and obligations of the obligor. There will also be a need for rating agencies to carry out a proper assessment of the debt instruments on offer, especially if it is desired to offer the securitization issues abroad.

The study finds that enacting legislation on asset securitization in Nigeria will have to contend with the issue of operation of a federal constitution in Nigeria because the applicable legal provisions in structuring asset securitization straddle legislative competence of the federal and state governments. Having considered different contentions of the issue of legislative competence, the study recommends constitutional change to make asset securitization a distinct subject matter of legislation.

Chapter Seven

Legal Risk and Challenges of Asset Securitization in Nigeria

7.1 Introduction

Risk is part of day to day human existence. From time to time when we are faced with unexpected risk, we may alter our plans with a view to avoiding the risk. Just as there are risks in private life, business and financial transactions and dealings also involve risks. The decision to avoid the risk, or at least to mitigate it, will depend on whether we have an understanding of the nature of the risk.

In the context of asset securitization, which is an aspect of structured finance, different kinds of risk are involved. This risk may be economic or legal. An investor in asset securitization in emerging economies may be exposed to any or a combination of the following risk factors: country risk; liquidity risk; interest rate risk; inflation risk; default/credit risk; market risk; tax burden risk; operational risk; exchange rate risk; systemic risk; convertibility and transfer risks; global-specific risks; legal risk; cash flow risk; asset risk; third-party risk; and co-mingling risk.[863] Therefore, legal risk is one of the risks that asset securitization has to contend with particularly in an emerging economy.

The issue of legal risk becomes the more relevant in asset securitization in Nigeria because of the absence of specific legal and regulatory framework for asset securitization in which event any asset securitization transaction will have to depend on a medley of property legislations, corporate and securities laws, and the rules of common law and equity.

[863] O Sholarin (n 119).

In the premise, the focus of this chapter is to discuss the concept of legal risk, identify and discuss the different kinds of legal risk applicable in an asset securitization transaction as well as mechanisms that may be adopted to mitigate such risk. While the chapter finds that some of these legal risks may be avoided or mitigated by appropriate contractual provisions and proper structuring of the transactions using the facilities of the existing law. In the final analysis, it will be contented that it is only by enacting specific legislation targeted at addressing legal risks in asset securitization transaction that an enduring solution may be found.

7.2 The Meaning of Legal Risk

The phrase 'legal risk' is a combination of the word legal and risk. Legal may be defined as 'connected with the law'[864] while risk has been defined as the possibility of something bad happening at some time in the future; a situation that could be dangerous or have a bad result.[865] Thus, while risk may involve other things other than law, legal risk is a particular kind of risk that is connected with the law.

Legal risk relates to the likelihood of being sued or being the subject of a claim or proceedings due to some infringement of laws and regulations, or the commission of a tort such as negligence or some other act giving rise to civil liability.[866] It is not general understanding of legal risk that we are concerned with in this chapter. Rather, it is a legal risk in the context of the financial markets whereby the phrase 'legal risk' is frequently used to mean "the risk of technical defects in the manner in which a transaction is carried out,

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864 Oxford Advanced Learner's Dictionary (7th edn, Oxford University Press).
865 Ibid.
866 R McCormick, *Legal Risk in the Financial Markets* (Oxford University Press, 2006) 2.

resulting in loss, sometimes very serious financial loss, for those that put money at risk in the transaction."[867]

In this context, legal risk means risk of a legal nature that may affect the validity of and/or attainment of the goals and objectives of a transaction, in this instance, asset securitization transaction. The importance of legal risk may be seen in the fact that it may sometimes lead to what is called 'systemic risk' whereby the legal risk has a 'domino' effect in the market, either because the financial market failure of one major institution triggers failures in other institutions that have funds at risk with it or because the market as a whole has misunderstood the legal position on a point which is of particular importance to the recoverability of funds thought to be safely (or relatively safely) invested.[868]

In Nigeria, the practice of asset securitization is still untested water and as such it is imperative that a proper assessment of legal risks involved be undertaken with a view to avoiding possible spiralling of the legal risk into systemic risk upon introduction of the practice of asset securitization in Nigeria. The following risks identified will be discussed: transfer of asset risk; re-characterization risk; insolvency/claw back risk; and risk of the underlying security.

7.3 Transfer of Assets Risk

An effective transfer of the assets or receivables to the SPV is crucial to the creation of asset-backed securities which lies at the heart of asset securitization transaction. Therefore, it will

[867] ibid 2.
[868] ibid 2.

amount to a legal risk for the transfer of the receivables to the SPV to be defeated upon a challenge by the obligees of the receivables transferred.

Transfer of the receivables to the SPV still has to be effected by the mechanisms of assignment or novation under the general law in the absence of specific legislation for transfer of receivables in asset securitization transaction. The practical implications of this is that transfer of the receivables is thus susceptible to legal risks involved in effecting a transaction by assignment and novation under the general law.

One of these risks is that where transfer is by way of assignment, challenge may come from the obligee of the receivables that there has not really been an assignment of the receivables on the ground that the relevant documents do not validly create assignment. This may be illustrated by the recent case of *Julius Berger Nigeria Plc v. Toki Rainbow Community Bank Ltd*.[869] In that case, Respondent to whom two separate Local Purchasing Orders (LPOs) given to Pit-a-pat International Nigeria Ltd by the Appellant brought an action against the Appellants as well as Pit-a-pat for the money as being payable to the Respondent following the assignment. The Appellant raised preliminary objection that there is no privity of contract between the Appellants and the Respondent and as well challenging the assignment to the Respondent by Pit-a-pat of the benefits of the contract between Pit-a-pat and the Appellants. On the contention that there was no privity of contract, the Court of Appeal held that from the pleadings of the Respondent:[870]

> "... the claims are based on the facts of assignment of the benefits of the contracts as between the 1st appellant and the company to the respondent and alternatively, allegation of fraudulent

[869] [2010] 8 NWLR (Pt. 1198) 80.
[870] [2010] 8 NWLR (Pt. 1198) 80 at 100, per Garba JCA.

> misrepresentation by the Peter Morkah and the 2nd Appellant to the respondent. There is no pleading or claim in the respondent's writ of summons or the statement of claim based on a breach of contract between the respondent and the appellants or any one of them. The issue of privity of contract between the two parties did not therefore arise in the claim against the appellants".

While the conclusion of the Court of Appeal on the facts of that case is certainly right, it is submitted that the Court ought to have also adverted to the fact that assignment of contract is also one of the exceptions to privity of contract.[871]

On the issue of the challenge by the Appellants to the assignment, while the court held that no particular form or mode is prescribed or required by law for a legal assignment as long as the assignor absolutely and unequivocally indicates the transfer of the benefit, interest or title to the assignee, the court then examined the two exhibits relied on by the Respondent, that is, Exhibits D and G, as establishing the assignment. The court held that Exhibit D is a letter that in simple language conveyed the instructions that the payment cheque for the supply of the materials should not be released "to the company without prior knowledge of the manager" of the respondent. The court further held that the letter fell short of meeting the first essential element of a valid assignment which is that the assignment must be absolute and not by way of charge only. The Court thereafter considered another letter, Exhibit G, and held that the letter "is in straight-forward language which simply conveyed the intention and directive that the payment for the contract mentioned therein should be made to the respondent. The court therefore held that Exhibit G met all the three essential requirements of a valid assignment, that is:

- That the company was the owner or entitled to the benefit of the contract in question;

[871] See, I E Sagay, (n 425) 516.

- That the company had unconditionally, entirely and absolutely (by irrevocable mandate) given or transferred the benefits and title thereto to the respondent; and
- That the 1st appellant was notified in writing of the transfer of the benefit to the respondent.[872]

The practical implication of this decision is that it amply illustrates the legal risk of challenge of the validity of the assignment of the receivables to the SPV and also underscores the danger of inappropriate wordings of the language of the assignment. Were reliance placed on Exhibit D alone in that case, the results would have been that there is no valid assignment to the respondent.

While appropriate drafting of the language of assignment of the receivables to the SPV cannot be over-emphasized, this alone cannot obviate the possibility of challenge to the assignment and some other risks so far as reliance will still have to be placed on the general law of assignment in transfer of receivables.

As can be seen from the decision in *Julius Berger Nigeria Plc v. Toki Rainbow Community Bank Ltd*,[873] notice of assignment is a requirement for a valid legal assignment. Thus, while legal assignment "is obviously the cleanest, as it ensures that the sale is immediately effective against the seller, its trustee in bankruptcy (subject to the risk of claw-back, as set out below) as well as the obligators of the securitized assets",[874] it is less attractive to the originator from a practical perspective because of the requirement of notice to the borrowers of the securitized

[872] [2010] 8 NWLR (Pt. 1198) 80 at 110-111.
[873] [2010] 8 NWLR (Pt.1198) 80.
[874] J V Robbe (n 11) 22.

assets. This is because, originating banks are generally not keen to notify their clients of the fact that the receivables owed under their (mortgage loan or other contract) have been assigned to some unknown special purpose vehicle. It is unlikely the clients would appreciate the benefits asset securitization transaction offers to the bank.[875]

As a result of this, recourse is had to equitable assignment as same can be created without notice. In *Julius Berger Nigeria Plc v. Toki Rainbow Community Bank Ltd*,[876] it was held that a party to a contract can in equity also assign a contractual right in one of two ways; (a) he can inform the assignee that he transfers the chose to him or (b) he can instruct the debtor to discharge the obligation by payment to or performance for the assignee.[877]

7.4 Legal Risks of Transfer by Equitable Assignment

Absence of requirement of notice in equitable assignments poses legal risk to asset securitization. The absence of notice may, however, have some other effects.[878] One, the SPV might lose priority if the originator resells or charges the receivables to a third party. In order to mitigate this problem a clause is usually inserted in the transfer agreement prohibiting this. Where this has been done, rating agencies are content to rely on the SPV complying with the prohibition.

Two, debtors can continue to pay the originator. This is not a problem because the originator wishes to continue to collect and such payment is the most convenient from the point of view

[875] ibid 22. Another potential drawback of legal assignment is that the debt assigned must be current, i.e. legal assignment cannot relate to a future debt which, at the time of the transfer, is not in existence.
[876] [2010] 8 NWLR (Pt. 1198) 80
[877] [2010] 8 NWLR (Pt. 1198) 80 at 106
[878] It has been pointed out that notice serves four purposes: (i) to maintain the assignee's priority; (ii) to prevent equities arising as between assignor and debtor to which the assignee might be subject; (iii) to prevent the debtor from obtaining a discharge from the assignor; and (iv) to bind the debtor's conscience- P W Young, C Croft and M L Smith (n 726) 709.

of the parties. However, the continued collection by the originator may pose co-mingling risk. In order to mitigate this, a separate account may be set up in the name of the originator and the direct debit mandates given by the debtor may be amended or payments made by direct debit may be paid direct to the SPV's account rather than via the originator. Three, debtors can continue to acquire new set-offs. The effect of this will be to diminish the receivables where set-off by the debtor is possible. Four, the originator can vary the terms of the receivables. Lastly, it would be necessary to join the originator in an action by the SPV against the debtor.[879]

7.5 Contractual Mitigation of Risk of Equitable Assignment

A way of mitigating or dealing with the risk of equitable assignment is by insertion of contractual provisions called 'Title Perfection Events' in the Receivables Sale Agreement. The essence of these provisions is to stipulate the circumstances that the SPV can give notice of the equitable assignment to the underlying debtors and perfect the equitable assignment into legal assignment. The necessity for this is that the liquidator of the originator will thereby not become entitled to the receivables by giving the notice upon insolvency of the originator.

The title perfection event is an early warning trigger, designed to give the SPV advance notice of a higher risk of the originator becoming insolvent.[880] The title perfection events typically include:

- The downgrading of the credit rating of the originator below a specified level;

[879] P R Wood, (n 196) 134-5 para 6-045. See also J V Robbe (n 11) 22. See also, O Ajayi, 'Legal Aspects of Securitisation' (1998) 3 MILBQ No. 1, 21 at 38
[880] J V Robbe, (n 11) 22

- The filing of an insolvency petition against the originator;
- The non-compliance by the originator of any material obligation under the transaction documents; and
- The failure of the originator to account to the SPV for the collection of the underlying debts.

To enable the SPV have the requisite authority to make this notification on the originator's behalf, a power of attorney for this purpose is usually granted to the SPV upon signing of the transaction. The power of attorney will provide that the SPV has authority to complete all necessary steps to protect and perfect its interest in the assets.

7.6 Limitation of the Contractual Mitigants to Legal Risks of Transfer

The insertion of title perfection effect will at least theoretically assist the SPV in being able to perfect its interests in the receivables by giving notice before the setting out of insolvency. However, there are serious limitations to the protection afforded by the clause in practice.

Firstly, the onset of insolvency of the originator may be so sudden that the SPV would not have the opportunity of exercising the power to give notice pursuant to the title perfection event. Secondly, the clause does not overcome the difficulty and impracticability of giving notice to the obligors who may be numerous and spread over the country. In this regard, legislative intervention would be necessary to address the legal risk.

7.7 Legal Risk of Non-Assignability and Absence of Consent to Assignment

There is also the risk that the transfer of the receivables may be challenged and declared void on the grounds that the transfer was effected by assignment whereas the underlying contract between the originator and the obligor expressly prohibits assignment. This is because, as a matter of law, an assignment contravening an express prohibition on assignments is void irrespective of whether the assignee was aware of the restriction.[881]

Although, as a general rule, there is no need for consent of the obligor (debtor) to the assignment, in certain situations an assignment of receivables may be challenged on the grounds that there was no consent of the debtors to the assignment. This may occur where there are stipulations that the consent of the debtors is needed for the valid assignment of the receivables. For instance, there may be contractual stipulations to that effect, also where the contracts relate to personal contracts. Even though, theoretically, this legal challenge may be averted by obtaining consent of the debtors, in actual practice, this may be impracticable in securitization because of "debtor inertia in replying" and there are "usually just too many debtors.[882]

In Chapter Six, we highlighted and discussed that alternatives to the problem of assignability and requisite consent might include a trust of the receivables, a trust of proceeds, sub-participations or a novation but that these alternatives may not be practicable for asset securitization transaction.[883] In this connection, therefore, a veritable alternative for overcoming the problem of restriction of assignment is by enacting laws which override restriction on assignments with a view to improving the marketability of claim.

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881 *Linden Gardens Trusts Ltd v. Lenesta Sludge Ltd* [1993] 3 All ER 417. HL (assignment of asbestos-removal contract with "non-assignment" clause was void). This is notwithstanding that the courts construe restrictions on transfer narrowly since the law prefers the free marketability of property; P R Wood (n 196) 133, para 6-042. The court will construe a prohibition on assignment as prohibiting only absolute assignment and not assignment by way of security or a floating charge.

882 P R Wood, (n 196) 131-2, para 6-040.

883 See A Basiru, 'Structuring Wealth from Debt: An Appraisal of Legal Aspects of Securitization Transaction under Nigerian Law' Unpublished Ph.D Seminar Paper 3; P R Wood (n 196) 132 para 6-042.

Even though legislative intervention may be said to be at the expense of freedom of contract,[884] it is always permissible to constrain freedom of contract where public policy considerations dictates that freedom of contract be adjusted to advance laudable objectives. There are many economic benefits of asset securitization as indicated in Chapter Three. It is submitted that these economic benefits would justify legislative intervention to address the aspects of legal risks as it relates to transfer of assets/receivables to the SPV in asset securitization.

An example of legislative intervention is the provision of Article 9-406 of the US' Uniform Commercial Code which provides in substance that a term in an agreement between an account debtor and an assignor is ineffective to the extent that it restricts, or requires a consent for the assignment (including a security interest and its enforcement) of the account, (broadly a commercial receivable), chattel paper (mainly receivables secured on goods and leases on goods) or a payment intangible (mainly loan agreements) or give rise to a default, breach or right of termination. There is a similar provision in relation to promissory notes. The provision does not apply to a sale of a payment intangible or promissory note and there is an extension for certain consumer receivables. Rules of law, statutes and regulations are similarly overridden.[885]

Another example is that, in France, ComC 442-6 II c provides that the prohibitions on assignment in commercial contracts (except those in favour of consumers or banks) or provisions that require that consent to assignment be obtained are ineffective to prevent an

[884] P R Wood (n 196) 132, para 6-041.

[885] Note that there are separate provisions in relation to certain leases in articles 2A-303 and 9-407, to certain other intangibles in Articles 9-408 and to letters of credit in Article 9-409.

assignment or transfer of rights, both as against transferors and other third parties and as between contracting parties. Also, in Germany, HGB (commercial code) s 354(a), 1994, provides that receivables arising from business transactions governed by German law that are due from corporate or public sector entitles are assignable despite prohibitions on assignment. However, the debtor can still pay the original creditor regardless of notice of the assignment so that the assignee is unsafe.

It is hereby submitted that a legislative reform along this line will assist in addressing the legal risk of transfer by assignment, particularly the issue of non-assignability and absence of requisite consent when contractually stipulated.

7.8 Risk of Re-characterization

Re-characterization is the risk that the legal classification given to a particular agreement by the parties is not recognized or otherwise overturned by a court of law or another body, such as for instance a tax authority or supervisor.[886] For instance, a transaction structured as a sale may ultimately be re-characterized as a charge or creating some other security interests. The risk of re-characterization arises because it is trite law that characterising a transaction cannot be done merely on the basis of the epithet used by the parties to describe it. According to Knox J., in *Re New Bullas Trading Ltd*,[887] 'if the transaction is a cow and has cloven hooves, the parties cannot turn it into a horse by using equine terminology and say it is a horse.'

[886] J V Robbe, (n 11) 25.
[887] [1993] BCC 251, at 255.

The approach of Nigerian courts appears to be the same, and there is great emphasis on dealing with the substance rather than the form, as well exemplified by the case of *Jajira v. Northern Brewery*,[888] where the court held that it is the substantive transaction that will be looked at rather than the form of the document in which it is embodied.

The legal importance of the issue of re-characterization has been explained thus:[889]

> "In a way, securitisations in particular and structured finance generally, are more subject to the risk of re-characterization. Re-characterization sits at the roots of structured deals, as may have been structured with the specific intent or otherwise costly or cumbersome rule. In these cases, re-characterization may, via the back door, subject the transactions to the very rules they were designed to avoid".

In securitization, re-characterization is predominantly relevant in four instances:[890]

- In the case of a traditional asset or 'true sale' securitization the sale of assets from the originator to the SPV might be subject to re-characterization as a secured loan;
- In a synthetic securitization the transfer of credit risk from the same originator to the SPV might be re-characterized as an insurance contract;
- A floating charge is re-characterized as a fixed charge; or
- A repurchase agreement is re-characterized as a secured loan

The legal aspects of the risks of re-characterization in the context of asset securitization are discussed presently.

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888 [1972] NCLR 313 at 329. See also, *Smith v. Bridgend County Borough Council*, [2001] UKHL, 58, where the court re characterised the council's right to sell assets to off set a debt owing as a charge, regardless of the parties' words in the agreement to the contrary.

889 J V Robbe (n 11) 26.

890 ibid.

7.8.1 Re-characterization of the Sale/Assignment to the SPV as a Secured Loan or charge

The problem of re-characterization arises because if the assignment or sale of the receivables is re-characterized as a secured loan then it will amount to registrable security. A registrable charge in Nigeria created at home or abroad, over assets *in situ* or overseas requires registration at the place of incorporation[891] by virtue of Section 197(1) Companies & Allied Matters Act 1990 CAMA.

The risk of re-characterization is palpable in view of the fact that there are no universal and clear rules that can be set out, in determining whether there is true sale. Rather, the issue will be treated on the peculiarities of the case and the way the transaction has been structured. The courts in Nigeria will draw from English case law, subject to local circumstances, where there is no precedent in Nigeria.[892] The commercially minded Judge will probably follow English law, and the approach of the English Courts, on this point. However, Judges that are legalistic will probably follow another route, and just seek to see whether the transaction creates a charge, and not first whether it is not a sale. Assuming, that the approach will be legalistic, it will be useful to examine the test of what amounts to a 'charge'.

In this regard, reference will have to be made to legislations on mortgages[893], as well as section 197(11) of CAMA which defines a charge as including a mortgage. The hallmark of

[891] In *Carse v. Coppen* [1951] SC 233, the Scottish Court of Session held that the governing law to be considered in determining whether a company had created a valid charge was the law of the place of incorporation.

[892] See section 2 Interpretation Act, Cap I32 LFN, 2010, and *Agunanne v. NTC* [1995] 5 NWLR (Pt. 397) 541.

[893] This will be the Conveyancing Act 1881 and 1882 (UK) for most of Nigeria, and the Property and Conveyancing Law [modelled after the Law of Property Act, 1925 (UK)] applicable in a handful of States.

these is the equity of redemption of property conveyed. Secondly, the conveyance of title with the mortgage or legal charge is by way of assignment, lease, sub-demise or charge.[894]

A charge is an agreement by which a particular asset or class of assets is appropriated to the satisfaction of a debt, so that the creditor is entitled to look to the asset and its proceeds to discharge the indebtedness, in priority to the claim of unsecured creditors and junior incumberancers. Thus, the chargor grants an interest in, or over, the goods in favour of the chargee, which is of a proprietary nature. The chargor retains the property in his hands, and the chargee's interest is a defeasible one which is automatically terminated on payment of the debt which it secures.

It may be noted, parenthetically, that in distinguishing between a transactions by way of security the courts could also refer to the pledge or lien. These two, however, do not involve the transfer of the property in the goods concerned. Therefore, to the extent that the transfer of receivables involves transfer of property, it may not be difficult to contend that it is neither a pledge nor a lien.

7.8.2 The Commercial Approach to Re-characterization

The first point to note is the recognition of the commercial or market practice of financing through the sale, whereby parties enter into a contract to sell goods or receivables with the intention of using the 'sold goods or receivables', more or less, as security for the loan

[894] See I O Smith, *Nigerian Law of Secured Credit* (n 1) 244

advanced. In Nigeria this will include hire purchase, forfeiting, factoring and bills discounting, as demonstrated by the case of *Ayoke v. Bello.*[895]

What emerges from the cases is that one test the courts apply in analysing this kind of transaction, is a focus on the substance of the transaction as opposed to the form. So that if the parties really intend the transaction to be a 'sale', then their intention will be given effect. Thus in *Kingsley v. Sterling Industrial Securities Limited*, it was held by Winn L.J. that:[896]

> "In my definite view the sole or entirely dominant question …is whether in reality and upon the true analysis of the transactions and each of them, and having regard in particular to the intention of the parties, they constituted loan or sales...it is equally clear that each case must be determined according to the proper inference to be drawn from the facts and whatever the form of transactions may take the court will decide according to its real substance."

Therefore, the court looks at the substance of the transaction with a view to determining the true type of transaction that the parties have entered into. According to Lord Hanworth M.R in *Re George Inglefield Limited*[897]:

> "It is old law, and plain law, that in transactions of this sort the court must consider whether or not the documents really mask true transaction. If they do merely mask the transaction, the Court must have regard to the true position, in substance and in fact, and for this purpose tear away the mask or cloak that has been put upon the real transaction."

In examining whether a transaction is masked, what the court essentially does is to construe the words in the parties' contract with a view to discovering the commercial purpose evinced by the parties.[898] The best example we can give of this is the approach taken by the Court of Appeal in *Ayoke v. Bello*,[899] where one of the issues was whether the transaction titled "Credit Sale Agreement" was a sale of goods transaction governed by the *Sale of Goods*

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[895] [1992] 1 NWLR (Pt. 218) 380 – relating to hire purchase.
[896] [1967] 2 QB 747, at p. 780.
[897] [1933] 1 Ch.D 1 at 17.
[898] See *A. Berg, 'Off Balance Sheet Finance, WDA v. Exfinco'* [1992] 2 JIBL 58.
[899] [1992] 1 NWLR (Pt. 218) 380.

Law, or Hire purchase transaction governed by Hire Purchase Act.[900] The Court of Appeal appears to have taken the position that the nature of the transaction is to be determined from the intention of the parties as evinced by pleadings and evidence – as it was held that:

> "It is crystal clear from the pleadings and the evidence led by the parties that they intended the transaction to be credit sale which is governed by the provisions of the Hire-purchase Act …. Nowhere did the parties aver in their respective pleadings that their relationship is regulated by the Sale of Goods Law… imported into the case by trial Judge. Nor was there an iota of evidence led to demonstrate that the parties intended the application of the provisions of the Sale of Goods Law … to their business intercourse."

Two questions that the courts appear to consider where an agreement for the sale of goods [or of debt] has been challenged as being in substance lending on the security of such goods [or debts] are:

a. whether the documents represent the true intention of the parties; and

b. if the substance of the transaction differs from its form, [as well exemplified by the landmark case of *Welsh Development Agency v. Exfinco]*.[901]

7.8.3 Real Transaction or Sham?

Where issue of re-characterization arises, the Court will seek to determine whether the agreement, though called a sale, is in fact a sham. In this regard reference is made to *Snook v. London and West Riding Investments Ltd.*,[902] where Diplock LJ said:

> "I apprehend that, if [sham] has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations (if any), which the parties intend to create…"

Thus, for a challenger to demonstrate that the transfer of the receivables to the SPV is a sham, it must be shown that all the parties thereto had a common intention not to create the legal

[900] Cap H4 Laws of the Federation of Nigeria, 2010.
[901] [1992] BCLC 148.
[902] [1967] 2 QB 537.

rights, or obligations, incidental to that of a sale of the receivables. It may be possible to show that the document of transfer does not reflect the agreement of the parties by proving a collateral agreement, or at least a common intention, to that effect, or a subsequent variation of the terms.[903] It may thus be possible, for a court in trying to construe the true nature of the transaction, to look at the entire finance and other collateral documents, in ascertaining the true intention of the parties.

7.8.4 Intention and the Document

One may be tempted to surmise that a document is a sham where one part of the document purports to create a particular legal transaction, and there are inconsistencies with other provisions in the document. Nevertheless, coming to the conclusion that the transaction is a sham has never been an easy one for the courts. Thus, if the court is unable to so conclude, as they are not wont to, the document must be construed on the basis that it reflects the parties' intention, and discover whether that was to create a charge or a sale.

It is submitted that more often than not the substance of a transaction and the intention of the parties is discovered within the four corners of their agreement. The courts are reluctant, except in very limited circumstances, to go behind what parties have recorded to find what the contract means. This is a rule of evidence, and common law, in Nigeria. It was noted by Lord Watson in *McEntire v. Crossley Bros Ltd*[904] that:

> … the duty of the court is to examine every part of the agreement, every stipulation which it contains, and to consider their mutual bearing upon each other; but it is entirely beyond the function of a court to discard the plain meaning of any term in the agreement unless there can

[903] See *Lloyds & Scottish Finance Ltd v. Cyril Lord Carpet Sales Ltd* [1992] BCLC 609.
[904] [1895] AC 457.

> be found within its four corners other language and other stipulations which necessarily deprive such term of its primary significance.

This was also the position apparently taken by the Court of Appeal in *Julius Berger Nigeria Plc v. Toki Rainbow Community Bank Ltd.* In that case, Garba JCA observed:[905]

> "The letter in simple and clear language conveyed the instructions that the payment cheque for the supply of the above should not be released "to the company without the prior knowledge of the manager" of the respondent. The duty of the court in the interpretation of these clear and ambiguous words of the letter is to ascribe their ordinary grammatical meaning to them."

In *Agnew v. IRC*,[906] Lord Millet, in advising, said that in determining whether an agreement parties have made falls into the legal category which the parties sought to place their agreement is a two-stage process. The first stage is that of construction in order to gather the intention of the parties from the language they have used. The purport being to ascertain the nature of the rights and obligations they sought to create. The second stage is that of characterisation. This stage is a matter of law and does not depend on the intention of the parties. If their intention as gathered from the language of the agreement is to grant rights which are inconsistent with the nature of the right they intend to grant, then the court will put the agreement into its proper legal category, notwithstanding how the parties have chosen to describe it.

7.8.5 Bundle of Documents

In *Gisborne v. Burton*,[907] the court held that in finding out the intention of the parties, one must: (a) look at the scheme of a pre-ordained series of transactions as a whole, instead of concentrating on each pre-ordained step individually; and (b) all the documents involved in the transaction. On this basis, the court found that the series of transactions taken together

[905] [2010] 8 NWLR (Pt. 1198) 80 at 108.
[906] [2000] NZLR 223; affirmed on appeal sub nom In *Re Brumark* [2001] UKPC 28.
[907] [1988] 3 All ER 760, or [1989] QB 390.

constitute a composite scheme intended to avoid a mandatory statutory provision. In *Welsh Development Agency v. Exfinco*,[908] Staughton LJ refused to extend the decision of the court in Gisborne to the case, because there was only one master agreement before the court.

Therefore, while there must be relational integrity between all the finance documents in asset securitization, it ought to be ensured that there are no collateral transactions made in regard to the transaction that would make a court to find that it is indeed a sham.

The finding, from the foregoing discourse, is that the courts will construe the agreement to ascertain the intention of the parties as to their rights and obligations, and then measure these rights and obligations against the objective legal criterion of the type of transaction in issue.

7.8.6 Economic Meaning v. Legal Meaning

The courts, following, for example, the case of *Chow Yoong Hong v. Choong Fah Rubber Manufactory*,[909] will give effect to the legal meaning of a term, and not the commercial meaning, or economic reality. However, in the case of *McNiven v. Westmoreland*[910] the court held (*per* Lord Hoffman) held that it is perfectly legitimate to give effect to the economic realities of a term, and the term must first be construed to see whether it was intended to refer to a legal concept or a commercial concept. It is submitted that this functional approach to interpretation is in consonance with adopting a broad purposive approach to construction of statutes and documents, rather than a formalistic insistence on

[908] Supra.
[909] [1961] 3 All ER 1163.
[910] [2003] AC 311.

examining steps in a composite scheme separately.[911] However, if this approach is adopted by the Nigerian courts and applied to broadly commercial issues, there is a risk that commercial agreements may sometimes be re-characterized according to their economic function and not their legal nature.

The point, however is that when there is reference to a 'charge', under company law, it refers purely to its legal concept. Following this, it would appear that once it is accepted that a sale could be a method of finance, that the parties choose not to proceed by way of borrowing, or obtaining a secured loan, should not lead to a re-characterization of the sale.

7.8.7 The Inglefield Test

What appears to be the classical route to a determination of a true sale is what is described as the Inglefield Test. This was developed in the landmark case of *Re George Inglefield*,[912] where Romer LJ laid down what he considered essential differences between a sale transaction and that of a mortgage or a charge, that is:

- In a transaction of sale, the vendor is not entitled to get back the subject matter of the sale by returning to the purchaser the money that has passed between them.
- In a mortgage or charge, the mortgagor is entitled, until he has been foreclosed, to get back the subject matter of the mortgage or charge by returning to the mortgagee the money that has passed between them.

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[911] See *ICS v. West Bromwich BS* [1998] 1 All ER 567, 587.
[912] [1933] Ch.D 1.

The essential difference is that if the mortgagee realizes the subject matter of the mortgage for a sum in excess of that required to repay him, the balance must be accounted for to the mortgagor. Conversely if the purchaser sells the subject matter of the purchase, and realises a profit, he keeps it and does not account to the vendor for the profit.

Thirdly, if the mortgagee realizes the mortgaged property for a sum that is insufficient to repay the debt, then the mortgagee is entitled to recover from the mortgagor the balance of the money. Also, if a purchaser were to resell the purchased property at a price which was insufficient to recoup the money that he had paid to the vendor, he is not entitled to recover the balance from the vendor.

In concluding on the Inglefield Test which has been doubted on all fronts, the point is made as noted in *Welsh Development Agency v. Exfinco*[913], by Dillion L. J. in his leading judgement that:

> …there is no one clear touch stone by which it can necessarily and inevitably be said that a document which is not a sham and which is expressed as an agreement for sale must necessarily, as a matter of law, amount to no more than the creation of a mortgage or charge on the property expressed to be sold.

Inferentially, it would be necessary to examine each case on its merits and as a whole to decide whether in substance it amounts to an agreement for the sale of goods or receivables, or only to a mortgage, or charge, on goods and their proceeds. The words used are of critical importance. Therefore, there should be a deposit or a prepayment, and price balance, rather than premium, because the courts will have regard to the words and form used by the parties to discover their intention and the legal nature of the transaction.

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[913] Supra.

7.8.8 The Practical Implication of Re-characterization

In asset securitization, the re-characterization of the sale as a secured loan would result in a lethal cascade for secured creditors, including the note holders, in the following manners;[914]

- The originator would still be the beneficial owner of the securitized assets;
- The SPV would not have become the beneficial owner of these assets, but only an agreement had been entered into according to which it had been granted a security interest in these assets, subject to compliance with the requisite perfection requirements (the registration of the charge);
- Precisely because the SPV did not intend to vest a security interest in the assets, it would have been perfected and be void;
- If it had not acquired the beneficial interest in the first place, it would not have been entitled to charge the assets to the security trustee for the benefit of the note holders and other secured creditors; and
- As a result of this the SPV, in the event of a bankruptcy of the originator, the securitized assets would fall into the bankrupt estate, and the SPV would not even have the position of a secured creditor, and in turn and equally the note holders would only be holders of an unsecured note (and the other creditors of the SPV, such as swap providers and liquidity provider would not have secured claims against the SPV).

7.8.9 Need for Legislative Intervention

As can be seen from the elaborate discussion on the approaches of the court to the issue of re-characterization, the end results of a contest on the issue may well be difficult to predict *ex-*

[914] J V Robbe (n 11) 26.

ante. In the circumstances, it is preferable to address the legal risk by way of legislative intervention. A suggested legislative intervention will be: one, to set out the conditions that must be in a transfer of the asset to the SPV and then deemed such transfer complying with the conditions as "true sale"; and two, there is express provisions against re-characterization.

There may also be provision for deeming provision whereby the transfer of assets from the originator or seller to the special purpose vehicle shall be deemed to be a "true sale" when it results in the following:

a. The transferred assets are legally isolated and put beyond the reach of the originator or seller and its creditor;

b. The transferee special purpose vehicle has the right to pledge, mortgage or exchange those transferred assets;

c. The transferor relinquishes the legal right to transfer, pledge, replace, repurchase, use or otherwise deal with the assets or revenues of the assets without the consent of the holders of the asset-backed securities or their representatives;

d. The transferee shall have the right to profits and disposition with respect to the assets;

e. The transferor shall not have the right to recover the assets and the transferee shall not have the right to reimbursements of the price or other consideration paid for the assets;

f. The transferee shall undertake the risks associated with the transferred assets; and

g. Any further characteristics as defined by the Commission by regulation.

However, nothing shall prevent the transferor from engaging in the following:

a. Providing the usual warranties or representations with respect to the quality of assets, and assuming the obligation to repurchase or replace assets which fail to meet quality standards;

b. Providing a guarantee of payment on market terms;

c. Providing a guarantee of liquidity not amounting to a guarantee of payment;

d. Serving as an asset servicer;

e. Holding asset-backed securities subordinated to the rights of the other asset-backed securities holders.

It may also be provided that the originator or seller and the SPV shall be at liberty to select any method of transferring the assets, including without limitation, by novation, sale, assignment and declaration of trust. There should also be express provision against the risk of re-characterization for the purpose of transactions structured as asset securitization.

7.9 Insolvency/Claw-Back Risk

The risk of a claw-back refers to the possibility that the administrator, liquidator (or any other insolvency officer with the required powers) of the SPV (but also possibly of third parties unrelated to the asset securitization transaction that would benefit from the unwinding of the asset securitization transaction) would be able to challenge the validity of the sale of the assets (in a true sale securitization transaction) or the transfer of credit risk (in a synthetic securitisation) and all agreements related thereto.[915]

[915] J V Robbe (n 11) 23; See also J Chen, 'Asset securitisation and the Singapore insolvency regime' (2001) J.I.B.L., 16(8/9), 198-202 at 199.

7.9.1 Voidable Preference

In this regard, there may be a claim that the transaction amounts to a voidable preference. Section 495(1) of CAMA provides that any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property which would, if made or done by or against an individual, be deemed in his bankruptcy a fraudulent preference, shall, if made or done by or against a company, be deemed, in the event of its being wound up, a fraudulent preference of its creditors, and be invalid.[916]

This provision can therefore be invoked by the liquidator as a claw-back on the transfer of assets to the SPV by the originator on the ground that transfer constitutes a fraudulent preference. It is pertinent to note that what constitutes "fraudulent preference" has to be determined by reference to the provision of the Bankruptcy Act, 1979 (as amended).

Under the Bankruptcy Act, section 46(1) provides that every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred and every judicial proceeding taken or suffered by any person unable to pay his debts as they become due from his own money in favour of any creditor or of any person in trust for any creditor, with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if the person making, taking, paying or suffering the same is adjudged bankrupt on a bankruptcy petition presented within three months after the date of making, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in the bankruptcy.

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[916] It should also be noted that s 495(2) of CAMA provides that: "Any conveyance or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void".

It is, however, provided that the above provision section shall not affect the rights of any person taking title in good faith and for valuable consideration through or under a creditor of the bankrupt.[917] Further, by section 47 of the Bankruptcy Act, settlements and assignments in relation to the following transactions are protected subject to certain conditions:

(a) any payment by the bankrupt to any of his creditors;

(b) any payment or delivery to the bankrupt;

(c) any conveyance or assignment by the bankrupt for valuable consideration;

(d) any contract, dealing or transaction by or with the bankrupt for valuable consideration:

The conditions that must be complied with to save the transactions are:

i. that the payment, delivery, conveyance, assignment, contract, dealing or transaction, as the case may be, takes place before the date of the receiving order; and

ii. that the person (other than the debtor) to, by or with whom the payment, delivery, conveyance, assignment, contract, dealing or transaction was made, executed or entered into has not at the time of the payment, delivery, conveyance, assignment, contract, dealing or transaction notice of any available act of bankruptcy committed by the bankrupt before that time.

The object of the rule as to preference is "to prevent a creditor from gaining an unfair advantage by concluding a transaction with the company during the twilight period which precedes winding-up or administration".[918]

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917 Section 46(2) Bankruptcy Act, Cap B2 LFN 2010

918 R Goode, *Principles of Corporate Insolvency Law*, (3rd edn, Thomson Sweet & Maxwell, London, 2005) 456.

7.9.2 Disclaimer of onerous property

There may also be the risk that the liquidator may disclaim the transfer of the receivable to the SPV under the provisions of section 499 of CAMA. The section provides that where any part of the property of a company which is being wound up consists of land or any tenure burdened with onerous covenants, of shares or stock in companies, of unprofitable contracts, or of any other property that is unsaleable, or not readily saleable, by reason of its binding the possessor thereof to the performance of any onerous act or to the payment of any sum of money, the liquidator of the company, notwithstanding that he has endeavoured to sell or has taken possession of the property or exercised any act of ownership in relation thereto, may, with the leave of the court, and subject to the provisions of the section, by writing signed by him, at any time within 12 months after the commencement of the winding up or such extended period as may be allowed by the court, disclaim the property.

The proviso to section 499(1) of CAMA is to the effect that where any such property has not come to the knowledge of the liquidator within one month after the commencement of the winding up, the power under this section of disclaiming the property may be exercised at any time within 12 months after he has become aware thereof or such extended period as may be allowed by the court.

The section further provides that a disclaimer under the section shall operate to determine, as from the date of the disclaimer, the rights, interest and liabilities of the company, and the property of the company, in or in respect of the property disclaimed, but shall not, except so far as is necessary for the purpose of releasing the company and the property of the company from liability, affect the rights or liabilities of any other person.[919]

Even though the present writer is not aware of a Nigerian authority on the issue of onerous property in section 499 of CAMA, reference may be made to the summary of the principles in determining whether a contract was unprofitable as held in *Tranmetro Corp Ltd v. Real Investment Pty Ltd*,[920] per Chesterman J, that:

> "A contract is unprofitable for the purposes of section 568 if it imposes on the company continuing financial obligations which may be regarded as detrimental to the creditors, which presumably means that the contract confers no sufficient reciprocal benefit.
>
> Before a contract may be unprofitable for the purpose of the section it must give rise to prospective liabilities.
>
> Contracts which will delay the winding-up of the company's affairs because they are to be performed over a substantial period of time and will involve expenditure that may not be recovered are unprofitable.
>
> No case has decided that a contract is unprofitable merely because it is financially disadvantageous. The cases focus on the nature and cause of the disadvantage.
>
> A contract is not unprofitable merely because the company could have made, or could make, a better bargain."

7.9.3 Addressing claw back Risk

In structuring a true sale transaction, comfort may be obtained by ensuring:

(i) that the originator/seller is solvent at the time of sale of the assets because as discussed above voidable preference only applies when the originator is insolvent;

(ii) that the purchase price agreed is an objective fair price, or the collateral provided not excessive; and

[919] Section 499(2) of CAMA.

[920] (1999) 17 ACLC 1314 at para. 21 quoted in R Goode, *Principles of Corporate Insolvency Law* (n 918) 456. See also, J Lloyd, in *Re SSL Realisations* (2002) Ltd [2005] 1 BCLC 1 at paras 64-66.

(iii) that the transfer of the assets from the originator to the SPV is carried out at arm's length, on commercial terms and for good consideration.

It is recommended that another way of dealing with the risk of claw back is by legislative provision protecting the acquisition of the securitized assets by the SPV even upon insolvency or winding up of the originator.

7.9.4 Risk of Winding-up of the SPV

The insolvency risk of the SPV will be of concern to the investors who hold the debt instruments issued by the SPV. Usually, the investors will have been granted security over the securitized assets in return for the provision of funds by the bondholders to the SPV for the purchase of those assets.[921] This is usually by means of Security Trust Deed. However, the investors may also be unsecured.

7.9.5 Position of Investors/bondholders upon insolvency of the SPV

The position of the investors in the winding-up of the SPV will depend on whether there is an underlining security created by the SPV in support of the debt instrument. Where there is no security underlying the debt instrument, the investors/bondholders will be unsecured creditors. In this regard, they will only be entitled to claim after the preferential claims and the applicable rule is that of *pari passu* distribution.[922] The distribution to the other creditors apart from secured creditors[923] takes the form of a declaration and payment of

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921 See also J Chen (n 915)

922 V Finch *Corporate Insolvency Law- Perspectives and Principles* (Cambridge University Press, Cambridge, 2002) 64.

923 Secured creditors are those creditors that holds a mortgage, charge or lien on the company's property or any part of it, as a security for a debt due to him from the company; *Omojasola v. Plisson Fisko Nigeria Ltd* (1990) 5 NWLR (Pt. 151) 434.

dividends so that if there are insufficient assets to meet all the claims of the creditors, they are paid in proportion to the amount of their claims.[924]

The position of the secured creditors are however more robust. They are entitled to realize their security and he cannot be restrained by action from doing so.[925] Secured creditors may rely on their security and not prove their debt upon liquidation of the SPV, or they may surrender their security and prove for the whole debt as if they are unsecured creditors or they may realize the whole value of their security and prove, as unsecured creditors, for the balance after deducting the amount realized or the value of the security.[926]

It is because of the robust position that it is necessary to examine the legal risks that may lead to an otherwise secured creditor to become unsecured in the context of securitization transaction. However, before dwelling on that we shall examine the mechanisms for addressing the insolvency risk of the SPV.

7.9.6 Mitigating the insolvency risk of the SPV

The insolvency risk is addressed by mechanisms to ensure that the SPV will not become insolvent at all events and these mechanisms include; isolating the ownership and control of the SPV from the originator; restricting the business dealings of the SPV; imposing certain restrictions on the purchaser of the notes; and by reducing if not eliminating the risk of claw-back by an insolvency officer if the SPV in any event become insolvent.[927] While these mechanisms have been discussed in greater details in our previous seminar, we may still draw

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[924] J O Orojo, *Company Law and Practice* (n 380) 499.
[925] *Alitaia Arlines Ltd v. NIDB* (1967) FNLR 134.
[926] J O Orojo, *Company Law and Practice* (n 380) 497.
[927] J V Robbe, (n 11) 16. See also 17 – 18.

particular attention to the mechanism of limited recourse clause and non-petition for winding up clause. In this regard, it would be imperative to insert in agreement made by the SPV that any person who contracts with the SPV that such person agrees not to sue the SPV in the event the SPV fails to perform under the contract.[928]

Also, the rating agencies criteria would require that certain restrictions on the rights and actions of the note holders are inserted in the terms and conditions of the notes. In this regard, there may be clause that the notes are limited recourse. This means that recourse by the note holders[929] is limited to the collateral and other assets of the SPV encumbered in relation to the particular transaction.

The practical implication of the limited recourse clause is that the creditors will have no right to claim any shortfall from either the SPV or the originator. There may also be clause to the effect that there will be no petition for bankruptcy of the SPV.[930] Issue may of course arise whether a clause prohibiting petitioning for bankruptcy or winding up of the SPV will be enforceable under Nigerian law. It is submitted that such clause may not be enforceable under Nigerian law, the right to petition for winding up being statutory and under stipulated circumstances.[931]

Be that as it may, while the limited recourse and non-petition provision may not be enforceable, they may be made effectual by the mechanism of security trustee whereby by the

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[928] V Kothari Securitisation, *Asset Reconstruction and Enforcement of Security Interests* (n 6) 35
[929] As well as other secured parties like swap counterparties and deposit banks.
[930] J V Robbe, (n 11) 17
[931] See s 408 of CAMA for circumstances under which a company may be wound up and s 410 of CAMA.

terms of the trust deed, parties agree that it is only through the security trustee that action may be taken against the SPV.

7.10 Risk of the Underlying Security Interests

The security interests underlying the receivables transferred to the SPV and upon which the debt instruments were issued is of significance for at least two reasons. Firstly, as earlier discussed, the position of the investors or bondholders is more robust where they can be categorized as secured creditors upon the insolvency of the SPV. Secondly, the security trustee can always realize the security and use the amount realized in paying the bondholders in case of default by the debtor.

Therefore, it will constitute a risk where the underlying security is negatively impacted legally. The legal risks involved may be as a result of a finding that the security is not perfected. The perfection of the security interests makes it binding on third parties and perfection events include, stamping, registration and where the security interest is land based, consent of the governor or the local government.[932]

The law relating to perfection of security interests under Nigerian Law depends on the kind of security interests involved. Aside complexity of the law, perfection of security interests is not cost and time-efficient with the implications of pushing the cost of asset securitization higher and possibly makes the transaction unattractive to both the originator and investors/bondholders. For instance, the security interests underlying the receivables ought to be assigned to the security trustee. However, where the subject matter of the security is

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[932] See generally, A Basiru, *Critical Evaluation of Perfection of Security Interests under the Nigerian Law*, (n 209).

land, absence of consent of the governor or the local government will render the transaction void[933] even though the assignment of the security is basically to facilitate financing by the originator to the SPV created for that purpose.

It has been submitted that security transaction should be excluded from consent requirements.[934] However, an amendment of the relevant provisions of the Land Use Act has to comply with the same elaborate provisions on amendment of the Constitution.[935] Unfortunately, despite the avalanche of critical opposition to the consent provisions of the Land Use Act by judicial and academic commentators, there is no provision for amendment of the Act in the on-going efforts at amending the 1999 Constitution.

The existing law on perfection of security interests is far from adequate and satisfactory in engendering an efficient and effective security rights system that will assist in the development of the economy by creating easy and cost-effective access to credit for myriads of economic endeavours and thus that there is need for the reform of the existing law to take care of the existing inadequacies.[936]

Another possible risk in relation to the security interests is that of loss of priority. Priority is crucial in determining the efficacy of the security created by the SPV in favour of the investors/bondholders because even though a security interest may be valid, perfected and

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[933] See section 26 of the Land Use Act. See generally, A Basiru, 'Savannah Bank v. Ajilo Resurges in Full Force, (n 533) 159.

[934] See T Ajala (n 802) 394-395. See also. See, A Basiru, 'Critical Evaluation of Perfection of Security Interests under the Nigerian Law' (n 209).

[935] See sections 315(5) and 9(2) of the 1999 Constitution, Cap C23 LFN, 2010.

[936] See, A Basiru, 'Critical Evaluation of Perfection of Security Interests under the Nigerian Law' (n 209).

enforceable, it may yet prove ineffective due to priority of other interests, particularly in a situation where available resources are insufficient to meet all claims.[937]

According to Omotola, "[T]he necessity for a clearly defined and well-settled order of priority stems from the fact that most species of property are capable of accommodating two or more concurrent subsisting interests, which are in competition with or antagonistic towards one another".[938] In the course of this study, it is found that there is asymmetric relationship between perfection and priority of security interests. Also, the present rules on priority of security interests under the Nigerian law are complex, cumbersome and is not conducive to an efficient system of secured credit transactions. We have therefore suggested that there is a need for reform of the law in this regard.[939]

The legal risks underlying security interests also manifest in the context of enforcement of the security interests considered in Chapter Five.

7.11 Summary

A discussion of the different kinds of legal risks in asset securitization like, risk of transfer of assets, risk of re-characterization, risk of insolvency/claw-back and risk of the underlying security was undertaken. The various contractual means of mitigating these risks were also highlighted. This chapter examines the concept of legal risks and relates it to aspects of asset securitization. The chapter finds that legal risks are those that may negatively affect asset securitization which are connected with the law. The study submits that while there are other

[937] O Sanni, (n 194) 24, 41.
[938] J Omotola (n 211) 135.
[939] See, A Basiru, 'Expository and Critical Analyses of Priority of Security Interest under the Nigerian Law' (n 209).

risk factors associated with asset securitization like economic risk, currency risk, country risk and so on, legal risks constitutes a distinct class of risks that may negatively impact on asset securitization. The importance of legal risk was pointed out in that legal risk may lead to systemic risks with attendant negative impact on the economy.

Regarding transfer of assets risks, the study finds that while valid transfer of the assets/receivables is crucial to asset securitization, there may be risk of a successful challenge of the transfer of the assets on grounds like invalidity of the transfer, issue on contractual non-assignability clause and contractual prohibition of assignment without consent of the debtor. The study discusses the problem and impracticability of giving notice of the assignment and thus the attraction of equitable assignment despite the risks associated with equitable assignment. While it was pointed out that the risks of equitable assignment may be addressed of contractual mechanism of 'Title Perfection Events', the study submits that there is a need for legislative intervention to address the risk of transfer of assets.

The issues and problems relating to risk of re-characterization were also examined. While it was found that re-characterization may prove lethal to asset securitization, upon an elaborate examination of the judicial approach to the issue of re-characterization as well as contractual mechanism to be adhered to by legal experts, it was found that it will be pretty difficult to predict with certainty the outcome of a re-characterization contest.

Insolvency and claw-back risks also portend serious danger to successful securitization. In the context of insolvency of the SPV, it was found that the position of the investors/bondholders will be negatively impacted if they were to be unsecured creditors. The study highlights the ways by which legal risks may be mitigated, while suggesting the need for express legislative safeguards in this regard.

Chapter Eight

Summary, Conclusion, Recommendations and Contributions to Knowledge

8.1 Summary

In the introductory chapter, the study discusses the background to the study, statement of the problem, aims and objectives, operational definition of terms, research questions, theoretical framework and research methodology. The study expresses preference for efficiency theory of asset securitization and being a legal research, it adopts analytical research methodology. The study establishes that asset securitization is one of the new methods of financing beyond the horizon of the traditional equity and debt financing.

A distinction is drawn by the study between asset securitization and securitization in the literal and general sense and establishes that the end product of asset securitization is the creation of asset-backed securities, (ABS), which is distinguished from securities in the usual capital market instruments. The study finds that the distinction between a usual capital market instrument and an ABS is that whereas the former is an exposure in the business of the issuer, the latter is an exposure in an asset, or a bunch of assets.

The study establishes that because of the peculiar structure of asset securitization, different laws will be applicable in structuring an asset securitization under the existing law. The study however finds that with the applicability of the different laws by itself does not constitute a problem but that the problem is that, while asset securitization has its peculiarities, these potentially applicable legal provisions were fashioned out as general property and corporate law provisions not specifically tailored for asset securitization. Due to the fact that it is general law that will have to be adapted to structuring asset securitization, the study highlights that this raises the problem of adequacy of the law and possible legal risks to asset securitization under existing law.

Additionally, the study establishes that because of the nascence of asset securitization in Nigeria resulting in paucity of literature in the area of study this work fills the gap in existing literature as a seminal work on asset securitization and its challenges and prospects in Nigeria as well as relationship between asset securitization and security interests. In addition, the study offers discussion of challenges of priority and enforcement of security interests as part of the necessary legal infrastructure facilitative of asset securitization.

The study further considers issues of possible merits of utilisation of asset securitization generally and particularly in Nigeria as well as challenges and prospects of its promotion. The study undertakes an expository and critical appraisal of priority of security interests under Nigerian law and, the position of the law in England from where Nigeria received its law. In addition, and for comparative reason, the position of the law under Article 9 of US Uniform Commercial Code as well as Personal Property Security legislations jurisdictions and the position on international plane under the EBRD and OAS Model laws and some relevant convention as regards priority are also examined. The study establishes that issue of priority and its determination arises because of possible conflicting claims by two or more persons in relation to a property due to the fact that the law recognises that multiple interests can exist in respect of an asset. It was found that the issue of priority is not only crucial to the value of security but may in fact determine the accessibility of credit advances to debtors. In view of the fact that credit advance is crucial to economic development of a society, it was submitted that the importance of rational, simple and coherent rules of priority of security interests cannot be overemphasised.

Next is the examination of the nature and types of priority disputes and the views of commentators like Goode, Sykes and Walkers, and Keinan on the subject. The study finds that apart from the problem of determining priority between secured creditors, there are other problems such as the determination of the priority between secured and unsecured creditors, and between secured creditors and good-faith purchasers. Although the primary focus of the study is on competing claims between rival claimants where two or more security interests have been created over the same secured property, the position of an outright buyer of a property in a competing claim against a secured creditor in respect of the same property also becomes relevant.

Debates as to whether according priority position to the claims of secured creditors is justifiable are also examined. The views of commentators like Vinch, Mokal and Goode were examined. One view is that priority of secured creditor is not justifiable because it violates the basic principle of rateable distribution of the estates of an insolvent person and it derogates from the principle of consensual non-subordination. The other view is that priority of security interests is justifiable on the grounds of freedom of contract as well as value, notice and arguments. The relative strengths and weaknesses of these contentions were examined. While, the study finds that none of the contentions either against or in support of priority position of security interests may singly stand without its own adverse criticisms, the study submits that the position of Vinch stems from the standpoint that security interests bypassed the *pari-passu* rule but this is not the case. Therefore, the study submits, that the proper inquiry should be whether, as matter of policy, it is justified to continue to recognise the priority position of secured creditors and if the answer is in the affirmative, what will be the consideration for such recognition and the boundary of the priority rights, particularly *vis a vis* unsecured creditors.

The study also examines, on a comparative basis, the position of the law on priority under Article 9 applicable in the US and under the Personal Property Security legislation applicable in Canada with a view to demonstrate the pattern that the needed reform of Nigeria law should take.

The study examines challenges of enforcement of security interests against the background of the finding that difficulty in enforcement of security will negatively impact the success of asset securitization. The study also considers the use of preliminary objection to frustrate enforcement of security and the possibility of its abuse to frustrate enforcement action. A consideration of the recently enacted LSMP Law was undertaken in the study.

There is also a discussion of the legal frameworks for structuring asset securitization under the existing law and legislative competence to enact law on asset securitization. The study highlights the basic process or structure of asset securitization and discusses the legal issues surrounding different aspects of its structure. The study examines the issue of possibility or otherwise of assignment of future, potential and contingent chose in action and submits that while it may be undisputable that present, future and potential receivables can be assigned, there may be some controversies as to whether a contingent right can be assigned. The study further submits that the present state of the law has therefore gone beyond the issue of un-assignability of future, potential and contingent receivables. The study also considers the status of the SPV in asset securitization. It is submitted that a fundamental objective in structuring of the SPV is to attain bankruptcy remoteness, that is, that the possibility of the SPV becoming bankrupt or insolvent should be remote and that the whole essence of securitization will be defeated if the SPV can easily become bankrupt or insolvent.

The study also discusses legal and practical issues relating to transfer of assets/receivables to the SPV. It is found that the issue of pricing is important and that, usually, the receivables may be sold at a discount with a view to reflecting that some of the receivables will be uncollectable as well as the financing cost to the SPV for funding the purchase. Also, the study considers the issue of assignability of the receivables in the context of the transfer of the receivables to the SPV. The study finds that there are situations where the consent of the debtors is needed for the valid assignment of the receivables due to various reasons and that this may well be impossible or difficult from practical point of view.

There is a consideration of legal issues as regards transfer of security interests supporting the assets or receivables to the SPV by way of assignment. The study submits that, in Nigeria, where the security is a mortgage over land, consent of the local government or the governor is mandatory. The study also examines legal aspects of issuance of securities by the SPV to the public. In this regard, the relevant provisions contained in the Investment and Securities Act, 2007, Securities and Exchange Commission (SEC) Rules and Regulations and Nigerian Stock

Exchange Listing Requirements are discussed. Further, the study examines the vital role played by rating agencies in securitization transaction and submits that the recognition of a Nigerian rating agency with a foreign rating company is commendable as it is capable of integrating the rating system in Nigeria within the context of the global business.

The issue of legislative competence to make law on asset securitization and the possible contentions in this regard is also discussed. A discussion of the different kinds of legal risks in asset securitization such as, risk of transfer of assets, risk of re-characterization, risk of insolvency/claw-back and risk of the underlying security was undertaken. The various contractual means of mitigating these risks are also highlighted in coming to the fnding that there is need for specific legislation to address the legal risks in asset securitization.

8.2 Findings

1. On rationale and benefits of asset securitization, the study finds that asset securitization avails the banking system lower solvability ratios and risks linked to financial sectors and regions and better financing conditions for companies and households. In this regard, it may assist in resolving liquidity problem of Nigerian banks with huge receivables. Further, the study finds that asset securitization: reduces agency cost; reduces the liquidity risk in the financial system; disperses holding of financial assets; promotes savings; and diversifies risks; serves as regulatory arbitrage tool; is an efficient and flexible funding and capital management technique for both financial institutions and large corporations; is an alternative and diversified market-based source of refinancing economic activities; enables the originator to raise funds

in the capital market by asset securitization at a lower cost than if it had borrowed the funds. Additionally, the benefit of asset securitization in allowing the originator to obtain immediate fund for its receivables and its potential in reducing funding cost in the long run make it imperative for a serious consideration of its use in Nigeria. It also found that asset securitization may be of benefit to Nigeria as it can effectively address the problem of inability of the emerging countries to issue financial securities of their own due to extremely stringent measures and market conditions.

2. It is found that there is a distinction between security interest and asset securitization but that the economic effect of securitization and security interests are similar. Notwithstanding the distinction between the two, the study finds that adequate security interest laws are important in structuring asset securitization transaction. The study finds that existing law on security interests, particularly in the areas of priority and enforcement, is inadequate to support a robust asset securitization market in Nigeria.

3. The study finds that there are existing legal provisions like the Investment and Securities Act, Securities and Exchange Commission Rules, Listing Rules of the Nigerian Stock Exchange, Companies and Allied Matters Act, Property Law Legislations, Registration laws, rules of common law and doctrines of equity that may be used to structure an asset securitization under the existing law. However, due to the fact that these are general laws but asset securitization has its legal peculiarities, the study finds that reliance on the existing law to structure asset securitization transaction may make asset securitization transaction susceptible to challenges in the form of legal

risks like transfer of assets risk, re-characterisation risk and insolvency/claw-back risk. While the study finds that there are contractual and due diligence mechanisms to address the insolvency/claw-back risk, it concludes that these may not be entirely satisfactory at all events.

4. On the legislative competence to make reform legislation on asset securitization, the study finds that the different legal aspects of asset securitization requiring reform straddles area of legislative competence of both the Federal and the state legislatures and that these may entail the different legislative houses to make reform laws on the different aspects of asset securitization within its legislative competence.

8.3 Recommendations

In view of the findings by the study, certain recommendations are made. The study recommends the need to further development of the mortgage market for asset securitization to emerge in the housing and mortgage sector in Nigeria. The need for adequate regulatory framework for mortgage transaction is also recommended. The study recommends that, in promoting asset securitization in Nigeria, there will be a need to consider the various aspects of necessary legislative and regulatory reforms to facilitate the transaction and ensure that the transactions are safeguarded so as not to become instrument of fraud in the long run to the detriment of the investing public.

On the plea of bona fide purchaser for value of the legal estate without notice, the study recommends that because the determination of whether a party is a bona fide purchaser depends on different factual variables, the continuous existence of the pleas may not augur well for certainty of the law on priority. It is recommended that a system of notice filing on security interests will be suitable in doing away with the plea. On the whole, the study recommends reform of the law on priority of security interests.

In view of the adverse effect of requirement of consent under the Land Use Act 1978, the study recommends that secured transactions should be excluded from the consent provisions. The study further recommends that there should be specific provisions that preliminary objections in actions for enforcement of security should be taken together with the substantive case and judgement on both be given by the court.

On agency of receiver/manager, the present writer recommends that rather than wait for a judicial reconsideration of the decision in *Unibiz* by the Supreme Court, an appropriate legislative reform of the law on agency of a receiver/manager is necessary and that the certainty of the law in this regard will aid asset securitization.

The study recommends that other states in Nigeria should adopt some of the provisions of the LSPM Law on the grant of interim and interlocutory injunctions, expeditious determination of enforcement actions and alternative dispute resolutions in reforming applicable mortgage law.

As regards challenges of enforcement of security interests, the study recommends that there is a serious need for the reform of the enforcement regime for security interests under Nigerian law to properly address the risk of the underlying security interest in asset securitization.

The study recommends that care must be taken that the transfer of the assets in asset securitization is legally binding and that the transfer is regarded in law as a true sale so as to avoid the risk of re-characterization and the attendant consequences. The study recommends that in resorting to assignment as a means of transfer of the receivable, it is important to properly scrutinise the underlying contracts and determine whether there is express prohibition on assignment.

As a result of the problem of assignability, the study recommends that alternatives to assignment might include a trust of the receivables, a trust of proceeds, sub-participations or a novation. Furthermore, the study recommends that an alternative for overcoming the problem of restriction of assignment is by enacting laws which override restriction on assignments with a view to improving the marketability of claim but that this legislative intervention may be said to be at the expense of freedom of contract. Examples of legislative intervention in the US, France and Germany were set out in the study. In addition, the study recommends that other states should adopt similar provision as section 46 of the LSMP Law on transfer of underlying security, where the security is mortgage, as it will benefit asset securitization.

The study recommends that the SPV must be structured as a public company to be able to offer securities to the investing public and that the security to be issued by the SPV must be registered with the Securities and Exchange Commission. The study further recommends that to reduce issue cost, exemption may be obtained from compliance with full prospectus requirements from the Nigerian Stock Exchange or a capital trade point under section 76 of the ISA.

The study recommends that there is need for specific law on securitization transaction. It is also recommended that there may be a need to change tax and capital market laws, so the full benefits of asset securitization can be obtained. It further recommends that the legislative effort should address the rules on equitable assignments and registration of charges by SPV. Another recommendation is that stamp duties will have to be minimized, if not exempted, and VAT should not be payable upon the purchase of receivables. In addition, the return on the investments by investors should not be taxable, (neither should the SPV withhold tax before distribution). It is submitted that, in this way, cost and expense of securitization will be significantly reduced, while returns are enhanced.

The study also recommends that the Central Bank of Nigeria should make relevant rules aimed at providing banks with certainty as to the rules on asset securitization for the purpose of recognition of the accounting and financial treatment of the structured financing. It is further recommended that the rules on capital adequacy and lending limits should recognize asset securitization, as means of complying with these rules. The study further recommends that the Securities and Exchange Commission must come up with clear and specific rules on asset securitization transaction so that it is not turned to an instrument of fraud or other financial and money market crimes with attendant devastating effect on investors' confidence and the financial system.

Further recommendation is that market operators should, as a measure of self regulation, make market led rules on asset securitization, particularly on the transfer of rights and obligations of the obligor. There will also be a need for rating agencies to carry out a proper assessment of the debt instruments on offer, especially if it is desired to offer the securitization issued abroad.

The study recommends that there is a need for legislative intervention to address the risk of transfer of assets and express legislative safeguards to address insolvency risks. Finally, the study recommends constitutional change to make asset securitization a distinct subject matter of legislation by the federal legislature.

8.4 Contributions to Knowledge

1. The study provides legal analysis of the different aspects and issues in structuring asset securitization transaction in Nigeria.
2. The study offers a new legal framework and mechanisms to address the legal risks and challenges of asset securitization in Nigeria.
3. The study establishes a link between asset securitization and security interests and makes a case for reform of security interests in Nigeria as part of the necessary law reforms for promoting asset securitization.
4. This is the first study, to the best of the writer's knowledge to examine the constitutional issues that may arise in enacting specific legislation on asset securitization in Nigeria.

8.5 Suggestions for Further Studies

Asset-Backed Securities that is the end product of asset securitization process is capital market instrument. Invariably, the success of asset securitization depends on the vibrancy of the capital market. Therefore, the study recommends for further study, how the existing legal and regulatory framework of the Nigerian capital market can be reformed to support asset securitization in Nigeria similar to what obtains in advanced economies of the world.

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