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DRAFT CONVENTION ON ASSIGNMENT [IN RECEIVABLES FINANCING] [OF RECEIVABLES IN INTERNATIONAL TRADE]

Compilation of comments by Governments and international organizations

Addendum

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V.00-52444

States

SWITZERLAND

[Original: English]

I. GENERAL COMMENTS

We have the honour to revert to the note of the Secretary-General of the United Nations dated 29 November 1999 concerning the draft Convention on Assignment of Receivables. We welcome the opportunity to comment on the draft Convention, noting with satisfaction that the Working Group on International Contract Practices of UNCITRAL has accomplished an impressive piece of work. In particular, it can be expected that the draft Convention will remove obstacles to cross-border receivables financing and thus will facilitate such transactions. The draft Convention has been met with favourable initial reactions from the marketplace, indicating that the uniform rules correspond to practical needs.

We also observe that the draft Convention deals with all aspects of cross-border assignments in a comprehensive manner. We note, however, that the lack of a rule dealing with the form of an assignment could have a seriously disruptive effect on international trade practices. We are well aware that the issue has been discussed at great length, without the Working Group being able to reach a compromise. However, in view of the relative importance of the issue, we welcome any suggestion to address the issue, including suggestions to introduce options for Contracting States to choose from (such options could range from no form to written form requirements).

We shall limit our comments to the issues yet to be resolved at the Commission session as listed by the Secretary-General in the above-mentioned note.

Title/Preamble

With respect to the title, good arguments are put forward for the three options, but none of them is without shortcomings. It is essential to choose a title which relates to the broad scope of the draft Convention in international commercial assignments. The title should avoid to give the impression that important practices are excluded. We would, therefore, prefer a title which avoids any appearance that the scope of the draft Convention could be limited to assignments in receivables financing only and could read along the following lines: "Convention on Assignment of Receivables".

It is nevertheless desirable that attention is drawn to one of the most important aims of the draft Convention, namely to facilitate credit through receivables financing. The place to do this is the preamble and possibly also the commentary on the draft Convention. Thus, we prefer to retain the references to receivables financing in the preamble, including the examples for practices of receivables financing given in the third paragraph. Furthermore, language relating to this important aspect might be added in the commentary.

The term "receivables financing" is no longer used in the normative parts of the Convention, that is, all parts other than the Preamble. Hence, the respective definition in article 6 (c) should be deleted.

Scope of chapter V (article 1 (3))

The need for and the scope of chapter V on private international law has been the subject of a very controversial debate. However, a majority of delegations were inclined to include such rules in the draft Convention due to the lack of private international law rules relating to assignments in many legal systems. From this approach follows necessarily that chapter V must apply independently of whether or not the assignor or the debtor is located in a Contracting State. It would, in fact, be difficult to justify the retention of this chapter for the sole purpose of filling gaps pursuant to article 8 (2).

For these reasons, we would like, in principle, to have the square brackets around article 1 (3) deleted. Nevertheless, regard should be had to the somewhat independent nature of chapter V which is in fact a convention within the draft Convention. An opt-in mechanism for chapter V, rather than the opt-out mechanism currently envisaged by articles 1 (3) and 37, would reflect this situation more appropriately.

Financial receivables (article 5)

It is essential to meet the specific needs of the financial services industry with respect to assignments in international banking practice. The question is whether such practices should be entirely excluded from the scope of the draft Convention or whether specific rules should be provided. Although at the beginning of the work of the Working Group the draft Convention was thought to cover essentially trade receivables, we have now a text before us, which is suitable to regulate all types of commercial transactions and which meets the interests of the financial services industry to a considerable extent. Hence, it appears appropriate to include a specific set of rules along the lines of article 5 insofar as assignments in banking practice differ from assignments of trade receivables. For reasons of consistency, exceptions to the general rules should be as limited as possible and clear. Variant B appears to better meet these criteria. Variant A is rather unclear in its language and might give rise to more interpretation problems, even if it introduces fewer exceptions to the rules of the draft Convention than variant B. Whereas we favour article 5 in general and variant B in particular, we nevertheless deem it preferable to provide a positive definition of non-trade receivables rather than only a negative one as set out in article 6 (l). We are well aware of the difficulty in drafting a definition which is sufficiently broad to cover not only present practices but also future ones. However, we think that the matter is well worth further consideration by the Commission.

Definition of "location" (article 6 (i))

The definition of the connecting factor "location" has been the subject of great disagreement and continued discussion among the delegations. This fact seems to suggest that no solution is completely without shortcomings. However, a number of elements have emerged that should allow the

Commission to reach consensus. One element is the need for the use of objective criteria for the determination of location for the purposes of priority. For legal systems requiring publicity by means of registration to operate efficiently, third parties need to be able to determine easily the place in which they need to file or search. Another element is the flexibility in determining the location of the debtor for purposes of the application of the draft Convention. Yet another element, is the need to avoid departing from other uniform texts to a greater extent than it is necessary.

Article 6 (i) satisfies most of these requirements and therefore constitutes a valid basis for further discussion. However, we are sceptical with respect to special rules for defining the location of branch offices of banks. First, it is unclear whether such special rules are necessary. Second, in any event any special rules must satisfy the aforementioned principles, in particular that, for the purposes of the priority provisions of the draft Convention, any definition of location must turn around an objective criterion. A definition which relies on an entry into the books of a bank does not satisfy this requirement.

Proceeds (article 26)

With respect to article 26 on the law applicable to proceeds, we share the view that the concept of proceeds is a commercially sound one and should be addressed in the draft Convention. However, the way articles 24 and 26 are currently drafted could result in confusion and uncertainty. In particular, the relationship between article 24 (b) and 26 should be further clarified. Article 24 (b) deals with proceeds and the priority of rights in proceeds by way of a conflict of laws rule, subjecting "the existence and extent of the right ... in proceeds ..., and the priority ... in those proceeds" to the law of the State where the assignor is located. Article 26, on its face, deals with the same issues by way of a substantive law rule. In effect, article 26 provides a uniform rule with respect to an issue which, pursuant to article 24 (b), is left to the national law of the State where the assignor is located. Hence, those rules deal with the same issue in a conflicting way and, therefore, need to be further clarified. One way to clarify this matter would be to leave the existence and extent of rights in proceeds to the law of the State where the assignor is located, but to require these States to recognize rights in proceeds at least as provided in article 26, that is, to read this latter provision as a minimal rule. As a result, legal systems that recognize rights in proceeds more generously would not be affected.

Furthermore, even though the concept of proceeds is sound from the point of view of commercial practice, we strongly suggest to avoid the term "proceeds". This term clearly emanates from common law systems. As a matter of principle, a uniform law should never use terminology which has a unequivocal meaning in a given legal system because users belonging to this system normally overlook the uniform character of such a rule while users in other legal systems might encounter problems to understand the rule. The term "proceeds" could be replaced by terms such as "payment" or "substitute".

TUNISIA

[Original: Arabic]

Title

As indicated in its scope of application, the draft Convention regulates assignments by way of sale (for financing purposes, namely for obtaining value) and assignments by way of security (for obtaining credit). The title with the reference to "financing" does not adequately reflect the scope of the draft Convention, since it is limited to referring to assignments for financing (for value). Therefore, the title "Assignment of Receivables in International Trade" would be preferable, in particular, because it gives a complete indication of the scope and the objectives of the draft Convention. It would be advisable to adopt it and to exclude from the title any reference to receivables financing. It should be noted, however, that in the event that the reference to financing is retained, it would be preferable to redraft the title as follows: "Assignment of Receivables for Financing Purposes". Such a formulation would be more adequate and closer to the title in the French version (*"cession de créances à des fins de financement"*).

Preamble

In the first paragraph, it would be advisable to replace the word "uncertainties" by the words "lack of clarity". In the second paragraph, the words "assignment of receivables" and the words "receivables financing" have been suggested. The first expression: "assignment of receivables" would be preferable because the matter relates to the assignment of receivables for the purposes of obtaining value as well as for the purpose of obtaining credit. In the fifth paragraph, it would be advisable to replace the words "affordable rates" by the words "affordable costs" and to avoid the repetition of language, caused by the word "facilitate" and the word "affordable" therein (only applicable to the Arabic version). The suggested change would make the meaning of this paragraph more accurate.

Scope of application (articles 1, 2 and 3)

In paragraph (2), the word "unless" should be replaced by the words "if [the debtor] is not [located] ... ". In paragraph (4), it seems that there is an error in the number of the article referred to in this paragraph. The correct number is 40 and not 36.

Articles 2 and 3 contain definitions of internationality and assignment respectively. They have no connection with the scope of application. Therefore, it would be advisable to insert them into article 6 on definitions. Subparagraph (a) of article 2 should be simplified as follows: "The creation of rights in receivables as security for a debt or other obligation is deemed to be an assignment."

Definitions (article 6)

In subparagraph (e), in line with recent legislative trends allowing the use of modern means of communications, it would be advisable to use the words "information in a traceable written form" instead of the words "a communication in writing". Subparagraph (j) should be revised as follows: "'Law' means the law in force in a State, with the exception of the rules of private international law."

Effectiveness of assignment (article 10)

The words "at the time of the conclusion of the contract of assignment" should be replaced by the words "on the date of the conclusion of the contract of assignment."

Representations of the assignor (article 14)

Paragraph (2) should be revised as follows:"Unless otherwise agreed between the assignor and the assignee, the assignor may not be a guarantor as to the debtor's discharge by payment or to the debtor's financial ability to pay."

Public policy (article 25)

In paragraph (1), the words "the public policy of the forum State" should be replaced by the words "the public order of the forum State". It should be noted that, in the French version, the words "ordre public" are used.

Law applicable to the relationship between the assignor and the assignee (article 28)

Paragraph (3) should be revised as follows: "If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected, where the rules of its jurisdiction [do not permit agreement to choose the applicable law] [do not allow the application of its law to be excluded by agreement between the parties]."

Law applicable to priority (article 30)

This article is a repetition, in form and content, of the provisions of articles 24 and 25 and should, therefore, be deleted.

Application of the annex (article 40)

It seems that an error is made in the Arabic version of this article. Reference should be made to sections I and II or section III of the annex rather than the draft Convention. Before the words "this Convention", insert the words [of the annex to].

Article 43

In paragraph (3), the words "made on ... the date when the Convention enters into force" should be replaced by the words "made starting on the date on which this Convention enters into force".

International organizations

COMMERCIAL FINANCE ASSOCIATION

[Original: English]

I. GENERAL COMMENTS

The Commercial Finance Association ("CFA") would like to take this opportunity to formally commend the Working Group on its hard work and continued dedication to this project. The UNCITRAL goal of facilitating the development of international trade through the availability of business financing at more affordable rates will most certainly be aided by the greater clarity and consistency that the draft Convention on Assignment of Receivables ("the draft Convention") will bring to the practice of assignment of receivables.

The current version of the draft Convention (A/CN.9/466, Annex I) has made great progress at such clarity and consistency, while managing to balance the many and diverse legal systems and public policies of the participants. The specific comments noted below are offered by the CFA as an attempt to improve on this draft, in ways that are in harmony with the intent of those participants.

In addition, we would like to emphasize that, after completion and adoption of the draft Convention, there remains a need to make further progress in developing a public notice filing registry. The approach, currently included in the annex to the draft Convention, of permitting each State the option of adopting some form of notice registry system is an acceptable compromise necessary for the draft Convention to gain world-wide acceptance. However, it remains our firm belief that the transparency and certainty that a public registry system would provide in determining the existence and priority of competing claims are absolutely essential to the growth of receivables-based financing.

II. SPECIFIC COMMENTS

Subsequent assignments (article 1 (1) (b))

Article 1 (1) (b) needs to adopt the same requirement for subsequent assignments as is done for initial assignments in article 1 (1) (a). In order to have consistency in the application of whose legal regime applies to various assignments, for any subsequent assignment to be brought under the draft Convention, it must be clear that the assignor be located in a Contracting State. It is our belief that this has always been the intent of the Working Group.

Assignment of receivables other than trade receivables (article 5)

In light of the significant issues that still surround the possible application of variant A or B, or any alternative to them, the CFA is unable to offer its opinion at this time. Further discussion is needed in order to better understand the concerns of other industries or business practices which might be impacted by the draft Convention.

Definition of "location" (article 6 (i))

During the October 2000 session of the Working Group, the issue arose of whether a further refinement was needed for determining the location of a domestic branch of a foreign bank. Without any modification, the location would revert to the central administration of the bank itself, which could have impractical consequences. The U.S. delegation made the suggestion of focusing on the location of the entity on whose books the receivable is kept. This seems to be an acceptable solution, since this is in line with the normal practice of foreign branches. In addition, it could be easily included in standard assignment representations and warranties, mitigating the need for burdensome due diligence [discovery efforts] by the assignee.

Effectiveness and time of effectiveness of an assignment(articles 9 and 10)

The Commission would need to resolve the discrepancy in these articles as to the time an assignment of future receivables becomes effective. The time of effectiveness of the assignment of a future receivable needs to be tied to the conclusion of the contract of assignment, regardless of the fact that the receivable itself does not "arise" until a later date. This legal fiction is necessary not only for priority issues between competing assignees, it is critical for any bankruptcy analysis.

Contractual limitations on assignment (article 11)

The Commission would also need to address the question of the potential ability of the debtor to void the underlying contract. Since this could cripple the assignee's right to collect, it would be a major set-back to the intent of the draft Convention. Assignees understand that they must accept an assignment subject to any defenses arising out of performance of the underlying contract. However, in light of the important intent of articles 11 and 12 of mitigating the impact of contractual anti-

assignment clauses, permitting the debtor to use the breach of such a clause in an action against the assignor to nullify the contract itself would be totally contradictory to the supposed protection granted to an assignee in article 11 (2) who simply knew about the clause and decided to accept the assignment anyway.

Representations of the assignor (article 14)

Article 14 does not make clear whether representations are given only to the immediate assignee or also to any subsequent assignee. As a result, it is not clear whether any subsequent assignee may turn against the assignor for breach of representations. We think that it should be left to the parties themselves to determine who has the right to rely on the representations given. In the absence of express agreement to the contrary, the economic consequences of that decision of the parties should only flow to the immediate assignee.

Right to payment (article 15)

In trying to prevent an undue advantage to an assignee who violates an agreement with an assignor, article 15 (2) may be giving the debtor, or some other party, an unintentional windfall, if a notification given in violation of an agreement between the assignor and the assignee is ineffective for the purposes of article 20, 22 or 24 to 26. While an assignee who wrongfully notified the debtor should not benefit from it, these severe consequences should not befall the assignee regardless of the type or severity of the violation. At minimum, some limiting language should be added tying the violation to the penalty. The following phrase might be added in article 15 (2): ", if the provision of the agreement that was violated was intended to have a contrary effect."

Law applicable to competing claims (article 24)

There may very well be a significant discrepancy between the language of paragraph (a) (i) and the intent of the Working Group in determining the extent and priority of the right of an assignee vis-à-vis competing assignees. The prerequisite for applying this subsection is that the assignees must have received their assignments of the same receivable from the same assignor. In a chain of subsequent assignments (very probable in syndicated loans and asset securitization transactions where co-lenders and investors get their undivided interests through the means of a separate assignment), the ultimate assignee technically does not get its assignment from the same assignor. Therefore, if the draft Convention were interpreted literally, there would be no substantive rule in the draft Convention governing the competing claims of that assignee in competition with an assignee that, for example, received its rights in an assignment from the original assignor.

It is our belief that the Working Group did intend to cover this situation, based on the rationale that any subsequent assignments are derived from the original assignment and are thus, in the eyes of the Working Group, from the "same" assignor. Yet nowhere in the draft Convention is there any qualifying language applied to the term "assignor" causing one to distinguish between the original or any subsequent assignor. In fact, quite the opposite, article 2 (b) was inserted to make it clear that the

term could be used to refer to the initial or any subsequent assignor. A resolution of this problem might be to include clarifying language in the commentary, or revise the text of article 24 (a) (i) in order to show that the assignment came, directly or indirectly, from the same "original" assignor.

Article 36

The CFA strongly believes that no exception should be made for receivables arising from the sale or lease or mobile equipment to be covered by the draft Convention on International Interests in Mobile Equipment, currently being prepared by Unidroit. The more inclusive and comprehensive nature of the draft Convention requires that it be given priority.

EUROPEAN BANKING FEDERATION *

[Original: English]

I. GENERAL COMMENTS

The UNCITRAL Working Group on International Contract Practices, entrusted with the preparation of a uniform law on assignment of receivables, adopted at its last session in Vienna in October 1999 a draft Convention for submission to the Commission's session in New York in June 2000. In this draft Convention, the issues of the treatment of financial receivables and of the meaning of "location", amongst others, remain pending and the European Banking Federation is pleased to have the opportunity to put forward its views on these matters.

We welcome the initiative of UNCITRAL in drawing up this draft Convention and believe that the harmonisation of the law governing the assignment of receivables will considerably improve the availability of credit to support world trade. We believe, however, that it is important that the provisions of the draft Convention do not inadvertently disrupt the legal basis of widely used financial contracts and the availability of credit in support of trade. Therefore, we propose that these issues left pending by the Working Group should be resolved as follows:

1. The effectiveness of non-assignment agreements relating to financial receivables should be preserved where they form an inherent part of the transaction structure, a more limited exception than that in the current draft.

- In article 5, variant B is to be preferred, but the scope of the exception should be limited to articles 11 and 12, and only to cases where the debtor has not consented to the assignment.

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* The European Banking Federation represents the interests of more than 3,000 banks in the EU and in Switzerland, Norway and Iceland.

- The definition of "trade receivable" in article 6 (l) should be amended to exclude receivables arising under payments or securities settlement systems and receivables arising under financial contracts governed by netting agreements. Definitions of "payments or securities settlement system", "financial contract" and "netting agreement" should be added.

- "Financial contract" should be defined sufficiently broadly so that the exclusion applies to the common practice of financial institutions of providing credit facilities using a deposit or securities account as collateral, but not to such accounts more generally.

2. The definition of "location" should be consistent for all parties - assignor, assignee or debtor - and should make provision for branch offices.

- In article 6 (i) the "location" should be geared uniformly for the assignor, assignee and the debtor - and not only for the debtor - to the *"place of business most closely connected"* to the contract.

3. The overriding importance of international efforts to combat money laundering should be specifically acknowledged in the payment provisions.

- Article 19 should apply to assigned deposit accounts only to the extent that the deposit-taker is able to comply with relevant identification requirements.

II. DRAFTING PROPOSALS

Limitation on receivables other than trade receivables (article 5)

We propose that variant B be adopted, with the addition of the words "unless the debtor consents" and with the deletion of the words "...and section II of chapter IV..." so that the text would now read (changes underlined):

> " Unless the debtor consents, articles 11 and 12 apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law."

Definitions and rules of interpretation (article 6)

We propose an amendment to article 6 (i) to make the definition of "location" consistent for all parties, assignor, assignee or debtor, so that this definition reads (changes underlined):

> "(i) (i) a person is located in the State in which it has its place of business;

(ii) if the assignor or the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract;

(iii) if the assignee has more than one place of business, the place of business is that which has the closest relationship to the assignment contract;

(iv) if a person does not have a place of business, reference is to be made to the habitual residence of that person."

We propose an amendment to article 6 (l) to give greater clarity to matters excluded from the definition of "trade receivable", so that this definition reads (changes underlined):

"(l) "trade receivable" means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than receivables arising under payments or securities settlement systems and receivables arising under financial contracts governed by netting agreements or used as collateral."

We also propose the addition of three further definitions in article 6:

"(m) "payments or securities settlement system" means any contractual arrangement between three or more participants with common rules for the settlement of payment or security transfer orders, and of any related collateral, between the participants, whether or not supported by a central counter-party, settlement agent or clearing house.

"(n) "financial contract" means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, any deposit transaction and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above, and any collateral or credit support related to any transaction referred to above.

"(o) "netting agreement" means an agreement which provides for one or more of the following:

(a) the net settlement of payments due in the same currency on the same date whether by novation or otherwise,

(b) upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other, and

(c) the set-off of amounts calculated as contemplated by the preceding phrase (b) under two or more netting agreements."

Debtor's discharge by payment (article 19)

We propose that paragraph (5) should be amended so that it reads (changes underlined):

"(5) If the debtor receives notification of the assignment from the assignee, the debtor is entitled to request the assignee to provide within a reasonable period of time adequate proof that the assignment has been made and, where the receivable is a deposit, to comply with any requirements imposed to prevent money laundering as if the assignee were a depositor, and, unless the assignee does so, the debtor is discharged by paying the assignor. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place."

III. SPECIFIC COMMENTS

1. Why are banks and other financial institutions concerned about preserving the efficacy of non-assignment agreements in financial transactions?

At first sight, it might appear that a bank or other party to a financial transaction is in no different position from any other debtor in relation to any other transaction. But this is not the case. Many financial transactions involve credit risk and assignment increases not only the credit risk involved, but also the security, litigation, insolvency and regulatory risks involved.

For example, a bank provides a letter of credit via its correspondent to a third-party exporter on behalf of its importer customer against an undertaking by the customer to reimburse the bank for any amount paid under the letter and with the security of a deposit by the customer. The bank will use the deposit in the event that the customer fails. If the customer assigns the deposit to an assignee before failing, the assignee may request payment from the bank, leaving the bank to claim against its customer, a credit risk for which the bank had not contracted (that was, after all, why it took the deposit as security). In this case, a non-assignment condition on the deposit is an inherent part of the transaction and, if its efficacy is called into question, such arrangements will no longer be made available to customers.

Another typical transaction is an interest-rate swap where payments indexed to a fixed rate by one party are netted against payments indexed to a variable rate by the other to leave a flow in either direction. In this case, the credit exposure can vary during the life of the swap as interest rates change, and the individual payments before netting are often very large compared with the net amount actually paid.

Netting agreements extend this concept to cover a whole range of transactions and offset all the cash-flows and obligations to one net figure per currency for settlement purposes and one single figure in the event of default, including liquidation of either party. Within such an agreement, an assignment of an individual "receivable" would be a fundamental change to the structure and, for this reason, is generally subject to the prior consent of the other party to the agreement. The breach of such a clause of prior consent constitutes an event of default triggering the winding up of the whole agreement. As a result of "cross-default" clauses which are included in many financial agreements, a default on one

such agreement will cause all other agreements to be terminated with potentially fatal consequences for the customer and considerable risk to the financial institution whose whole portfolio structure may be disrupted.

The regulatory treatment of netting agreements is a significant factor in the willingness of banks to enter into transactions. Regulators recognize the reduction in credit risk by allowing a corresponding reduction in required capital and this, in turn, makes the transaction available to the customer at a lower price. But regulators will only accept netting as effective if the bank has obtained a clear legal opinion that the agreement will achieve the netting before, during and after insolvency. If doubt is expressed in the opinion as a result of uncertainty about the application of the draft Convention, the netting agreement will not be treated as effective for regulatory purposes, the capital benefit will not be available and the cost of the transaction will rise.

In addition, the assignment of certain types of receivables without the debtor's consent may lead in certain circumstances to inadvertent breach of national regulatory provisions. In some situations, such a breach may involve civil and criminal liability for the debtor. For example, a debtor may find itself in technical violation of United States security or commodity law (such as that applying to public offerings) if an assignor is able to assign certain types of transactions, such as repos, securities lending or currency swaps, originally contracted outside the United States, to an assignee located in the United States.

All these factors of uncertainty would undoubtedly lead to a reluctance among financial operators to use these financial instruments and this would reduce availability of credit for trade and thereby undermine the principal objective of the draft Convention.

2. *Are these concerns not met by the debtor-protection provisions in section II of chapter IV, or by the wording proposed in variant A of article 5?*

Although one of the most important debtor-protection provisions in section II of chapter IV (article 20) states that any assignment is subject to existing rights of set-off, the way in which the provision is framed means that it does not seem to extend to close-out netting mechanisms typically included in netting agreements, which are still contingent on a default and include all existing and future transactions within their scope. Also, close-out netting is not always accomplished using set-off as a legal mechanism.

Variant A of article 5 would allow the assignment of financial receivables but would provide that the rights and obligations of the debtor would not be affected in the absence of consent. The result of this complex combination would be that the assignment would be valid as between the assignor and the assignee but the debtor would be ostensibly unaffected. In the event of liquidation of the assignor, the debtor would also be a creditor and the assignee might dispute the priority of the debtor's claim in the liquidation. Article 24 provides that this dispute would be decided according to the law of the State where the assignor is located. Although the debtor might be successful in refuting the assignee's claim, this is unnecessary expense and the prospect of potential litigation will discourage financial institutions from entering into such contracts. It is also unrealistic to give purported effectiveness to an assignment in a context where such an action is inappropriate.

Whilst the regime proposed in variant B is clear, the one proposed in variant A is likely to constitute a factor of high legal uncertainty for the financial markets.

3. Why remove reference to section II of chapter IV from variant B of article 5?

If a receivable is not a trade receivable, article 5, variant B with the suggested revisions, would disapply articles 11 and 12. If as a result, an assignment is not effective because of an agreement not to assign without the debtor's consent which has been withheld, there is no assignment and chapter IV has no application. If, on the other hand, there was no need for the debtor's agreement or that agreement had been obtained, the provisions of chapter IV should apply as to any other receivable. We have no wish to reduce the scope of the draft Convention any more than is necessary to protect the transactions about which we have concerns.

4. Why change the definition of "trade receivable" in article 6 (l)?

The purpose of the amendments proposed to article 6 on definitions is to limit the scope of the exclusion of financial contracts. The original wording for the definition of "trade receivable" would have excluded "financial services", a term that is both extremely wide in its scope and also difficult to define. By excluding only receivables arising under payments or securities settlement systems, or under financial contracts governed by netting agreements or used as collateral, we propose to narrow the scope of the exclusion and limit it to certain categories of contracts or payments that are subject to netting or collateral arrangements necessitated by insolvency considerations, and mandated by international financial supervisory standards (including capital adequacy rules).

It is common for financial institutions to use deposits or securities as collateral for trade credit purposes. In such circumstances, the assignment of the deposit or securities is subject to the debtor's consent. To allow the account holder to assign such deposit or securities without restriction would strongly diminish the value of deposits or securities as collateral, which would in turn create as many difficulties for trade finance as the proposed draft Convention is designed to avoid.

5. Are the additional definitions required?

We believe that the additional definitions proposed in draft Article 6 (m), (n), and (o) improve considerably the clarity of the draft Convention and ensure that the scope of the exclusion for financial receivables is no wider than it needs to be to meet our concerns.

6. How is assignment affected by money-laundering prevention measures?

The international community has made the prevention of money laundering a key element of the fight against drug trafficking and other serious crime. Financial institutions have been made subject to specific requirements amongst which are those of customer identification and the establishment that funds have been received from a *bona fide* source. Deposit-taking institutions cannot agree to assignments of deposits to third parties unless they are able to complete the requisite identification and probity checks.

Our concern relates to fraud or misuse of funds. Suppose depositor Mr. Smith assigns the deposit to Mr. Jones. A person presents himself at the bank, says that he is Mr. Jones and provides a letter signed by Mr. Smith confirming the assignment. He then requests the bank to pay the deposit to him in cash or by international transfer to a third party. The bank is at risk of being a party to unlawful conversion of the funds, just as it would be if it dealt with a cheque from Mr. Smith in this way. Banks protect themselves by insisting on proper identification of Mr. Jones before accepting cheques payable to him. These identification checks are incorporated in the "know your customer" element of money-laundering rules, rather than the suspicious transaction element.

Article 19 appears to override the bank's right to insist on identification. There is protection in article 19 (5) that the debtor can demand written evidence that the assignment was made, but this does not solve the assignee identification problem. The change proposed to article 19 would clarify that the provisions of the draft Convention are not in conflict with money-laundering prevention requirements.

The proposals in our draft are, in practice, modest in effect.

- Most deposits will not involve an anti-assignment clause, so the question of the debtor's consent does not arise. Where there is an anti-assignment clause because the deposit is used as collateral, the same arguments as for netting agreements apply.

- Banks will generally insist on identification of the assignee, so the added words in article 19 (5) merely protect the bank and avoid any potential dispute. Again, most assignments are likely to be to other financial institutions, so the need for identification will be infrequent.

7. Why amend the definition of "location"?

Financial institutions are involved in assignments as debtors, assignors and assignees, and nearly all financial institutions operate through branches which generally transact business under local law and jurisdiction. We are, therefore, particularly interested in the provisions for determining the location of a party with more than one place of business. We believe that in the case of several places of business, the place which has the closest relationship to the contract must be preferred to that of the central administration currently stipulated for the assignor and the assignee in article 6 (i) (ii). This criterion of "central administration" is particularly questionable as far as the assignor is concerned, basically for three reasons:

- first, in cases where the assignor is affiliated to an internationally operating group, it is not *ipso facto* clear to outsiders whether the contractual relationship is entered into with a dependent branch or with an independent subsidiary;

- secondly, reference to the central administration (or head office) may result in an assignment that is carried out through the branch of a company outside the country where that head office is located (being classified as an "international assignment"), even if this branch as well as the assignee and the debtor are all established within one legal regime which is different from the one where the head office is established. This would lead to the application of a legal regime which has no real connection to the contract.

For example, a company whose head office is established in France assigns a receivable through its branch established in Germany. The assignee and debtor are also located in Germany. Any reference to the head office (or central administration) would lead to the application of French law notwithstanding the fact that France has no real connection to the contract;

- finally, reference to the head office means that where competing law is concerned, application of the legal regimes of the head offices would be encouraged without taking into account any inherent legal connection of such regimes with the transactions involved.

A consistent definition of "location" for all parties to a transaction (assignor, assignee and debtor) will accord more closely with business reality and help to prevent any questions of competing legal regimes arising.

FINANCIAL MARKETS LAWYERS GROUP*

[Original: English]

The Financial Markets Lawyers Group wishes to endorse the recommendations recently made by the European Banking Federation ("EBF") to improve the text of the UNCITRAL draft Convention on Assignment adopted by the Working Group on International Contract Practices ("the Working Group") at its last session in Vienna in October 1999 ("the draft Convention"). We applaud the efforts of UNCITRAL to facilitate greater cross-border trade financing and believe that adoption of the draft Convention will lead to greater harmonization of the rules currently governing cross-border assignments of receivables.

We believe, however, that the draft Convention should not undermine the legal basis upon which international over the counter ("OTC") financial markets contracts are currently entered into and used as collateral. As the Working Group has been made aware, the standardized agreements presently used by OTC market participants generally include a provision expressly prohibiting the assignment of any underlying rights or obligations by one counter-party without the prior written consent of the other counter-party and provide for certain rights and obligations of the parties with respect to collateral.

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* The Financial Markets Lawyers Group ("FMLG") is organized as an independent body under the sponsorship of the Federal Reserve Bank of New York ("FRBNY") and is made up of representatives of the various United States and European commercial and investment banks that are active in the over the counter ("OTC") foreign exchange markets. The FMLG's primary responsibility is to coordinate various legal projects undertaken by the New York Foreign Exchange Committee ("FXC"). The FXC, which was likewise organized under the sponsorship of FRBNY, represents many of the most significant participants in worldwide foreign currency trading. The FMLG is also responsible for drafting legislation aimed at enhancing the integrity of financial markets and for preparing papers and model contracts on specific market-related topics.

These provisions lend certainty and predictability to the set-off and netting provisions of these agreements and thereby enable market participants to better manage their counter-party credit risk.

As a result, we agree with the EBF's suggested changes to the draft Convention and encourage the Commission to incorporate the defined terms "financial contract" and "netting agreement" into the draft Convention using the language suggested by the EBF. For purposes of clarification, however, we would like to note that it is our understanding that the EBF's definition of the term "netting agreement" is intended to include master netting agreements (such as those currently published by the FXC) that allow a party to close-out some but not necessarily all of the underlying transactions in certain situations.

We also share the EBF's view that the draft Convention should not apply to receivables arising from the operations of a payment or securities settlement system. Allowing participants of a securities or payment settlement system to assign their receivable is obviously likely to substantially undermine the fluid operations of such systems and impair the certainty and finality of settlements. We, therefore, agree with the EBF's recommendation that such receivables should be more clearly excluded from the scope of the draft Convention.

In short, we urge the Commission to endorse the textual changes suggested by the EBF in its comments. Again, we commend the Commission's efforts to develop a legal regime under which global trade financing can better flourish. We would be prepared to provide the Commission with any further information it may require.

EUROPAFACTORING

[Original: English]

"Location" (article 6 (i))

The issue of location of the assignor and the assignee is still an open matter, whereas the issue of the location of the debtor has been settled in a reasonably satisfactory way. The central administration rule will lead to predictable results with respect to the application of the draft Convention. However, if the assignor has a place of business (branch office) in a Contracting State and a central administration in a non-Contracting State, the draft Convention will not apply. The exception proposed with respect to branch offices of financial institutions is intended to reflect the idea that the scope of application of the draft Convention should be as wide as possible and to ensure that the draft Convention would apply to the cases just mentioned. We welcome that idea. However, there are two problems with the proposed exception. Firstly, an exception for branches of certain industries would be difficult to define (should banks be exempted, or financiers, or financiers and insurance companies, and under which law would be determined whether a specific business is a banking business). As a result, uncertainty would arise as to the application of the draft Convention.

On the other hand, the merits of such an exception would be limited. In view of the fact that the law applicable to priority issues is to be determined by reference to the location of the assignor, the exemption would result in the application of the priority rules of the country in which the branch office is located. It is not certain that such priority rule would be recognized in the country in which the

central administration of the assignor is located, and in which insolvency proceedings would likely be commenced. As a result, in order to be protected, the assignee would have to also comply with the priority rules of the country in which the central administration is located.

It might seem strange to business, but a receivable arising from a contract with a branch office is, legally speaking, a receivable vested in the legal entity located at its central administration. With respect to factoring, the importance of the envisaged exemption is minor, as factoring companies and their clients have places of business in countries, in which adoption of the draft Convention can be expected. With respect to banks with central administration in a tax haven (which would normally not adopt the draft Convention) and branch offices in financial centres, again the importance of this exemption would be minor, at least to the extent that such banks are likely to act as assignees rather than assignors (and their location would not play a role in the determination of the law applicable to priority).

It might seem a futile task to determine the different possibilities with respect to the application of the rule on location and the exception as to branch offices. However, we have tried to find, at least, a way to systematize and understand the solutions agreed on so far. In this context, we would note that, while the location of the assignor in a Contracting State is important for determining the scope of application as well as the applicable priority rules, the location of the assignee or the debtor is of no importance for those matters (with the exception of the question of internationality).

If mainly the location of the assignor matters, it would be wise to first establish to what extent business is affected by the rule and to decide accordingly as to any exceptions. The Commission may wish to focus on only a small number of cases with respect to receivables originating in the country in which the assignor is located and leave aside subsequent assignments to which, by virtue of the subsequent assignment rules, the draft Convention would apply for the reason that an international assignment had preceded.

Assignor	Branch office	Assignee	Branch office	Scope	Priority according to convention	
In contracting state (in)	In	In contracting state	none	Yes	yes	Transaction from main office
	out			yes	yes	
	none			yes	yes	
In non-contracting state (out)	in			no	no	
	out			No	no	
	In			yes	yes	Transaction from branch office
in		In	None			
	out			To be debated (yes)	To be debated (no)	
out	In			To be debated (yes)	To be debated (no)	
	out			No	no	
	In		none	Yes	yes	Transaction from main office
in		Out				
	out		In	yes	yes	
	none		out	yes	yes	
out	in		In	no	no	
	out		out	No	no	
	In		In	yes	yes	Transaction from branch office
in		Out				
	out		Out	To be debated (yes)	To be debated (no)	
	in		in	To be debated (yes)	To be debated (no)	
out						
	out		Out	No	no	

Form of assignment

The draft Convention does not contain any substantive rule on the form of assignment. To ensure certainty, at least as to the law applicable to form, the draft Convention should specify that the law of the country in which the assignor is located governs form requirements. Such an approach would be consistent with the approach followed with respect to the law applicable to priority issues. The draft Convention should also clarify that, wherever a written assignment is required, writing would be understood in accordance with the draft Convention, namely it would include electronic means of communication, even if such means are not recognized in the country of the assignor's location.

Financial receivables (article 5)

We have always welcomed the idea that the draft Convention should be aimed at improving the extension of credit at a lower cost, while not interfering with practices already available in the market. If such existing practices can be defined properly and isolated from practices involving the financing of trade receivables, such as factoring, we would not oppose any specific rules as to such practices. In this context, it is a matter of discussion whether the draft Convention or only certain provisions (e.g. articles 11 and 12) should not apply to such practices. The adoption of the draft Convention may be opposed by an industry group on the ground that specific exemptions were granted to one and not another group. However, based on the experience gained in the context of the adoption of the Ottawa Convention on International Factoring ("the Ottawa Convention") in Germany, which was opposed by certain groups solely on the ground of the anti-assignment clause rules, we would note that excluding certain financial practices from the scope of the draft Convention altogether may increase the acceptability of the draft Convention.

Relation to other international texts (article 36)

For policy reasons, it may be wise to subordinate the draft Convention to other conventions and, in particular, to the Ottawa Convention. The scope of the Ottawa Convention is very narrow (it does not even cover all factoring operations) and the rules of the two Conventions may be similar. However, such an approach would result in uncertainty. The parties may exclude the application of the Ottawa Convention as a whole (the UNCITRAL draft Convention does not allow such a total exclusion). If the parties exclude the application of the Ottawa Convention, the question arises whether the UNCITRAL draft Convention or national law would apply to fill the gap. Furthermore, the Ottawa Convention allows certain reservations with respect to the rule on anti-assignment clauses and two States have made such a reservation.

A regime with national and international rules and exceptions as to anti-assignment and with international rules with different content and scope of application would not be conducive to legal certainty or consistent with the main objectives of the draft Convention. In view of the above, while praising the draftsmen of the draft Convention for their modesty, we would suggest, with due respect to the Ottawa Convention, that the draft Convention should supersede the Ottawa Convention. To the extent that the draft Convention is widely adopted, such an approach would ensure certainty in all types of factoring operations universally. We reserve further comments until we have the opportunity to read the comments of Governments and other organizations. Subject to the invitation of UNCITRAL, we will be represented at the Commission session in June 2000 and we would welcome any comments on the ideas mentioned above.

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
(Unidroit)

[Original: English]

I. GENERAL COMMENTS

The Unidroit Secretariat takes this opportunity to compliment the Working Group on the excellent work it has accomplished in this difficult area. In general, it notes the indirect recognition of the debt owed by the draft Convention to the Unidroit Convention on International Factoring (A/CN.9/466, para. 193) and would suggest that consideration might usefully be given to this debt being acknowledged more explicitly in the Preamble to the draft Convention, for instance, by the introduction of a clause indicating that the draft Convention has built on the achievements of the Unidroit Convention. It notes furthermore the statement that "according to general principles of treaty law, the draft Convention would not prevail over the Ottawa Convention on the grounds that the Ottawa Convention was a more specific convention" (A/CN.9/466, para. 194). We would suggest that as much be noted in any explanatory memorandum that may be prepared in due course with respect to the draft Convention once adopted.

II. SPECIFIC COMMENTS

Relationship between the draft Convention and the preliminary draft Unidroit Convention on International Interests in Mobile Equipment and the preliminary draft Protocols thereto

Regarding the relationship between the draft Convention and the preliminary draft Unidroit Convention on International Interests in Mobile Equipment ("the preliminary draft Convention") and the various preliminary draft Protocols thereto under preparation, namely a preliminary draft Protocol on Matters specific to Aircraft Equipment ("the preliminary draft Aircraft Protocol"), a preliminary draft Protocol on Matters specific to Railway Rolling Stock and a preliminary draft Protocol on Matters specific to Space Property, the Unidroit Secretariat would first note that this matter was referred to the Public International Law Working Group set up at the Second Joint Session of the Unidroit Committee of governmental experts and the Sub-committee of the ICAO Legal Committee considering the preliminary draft Convention and the preliminary draft Aircraft Protocol, held in Montreal from 24 August to 3 September 1999. The Public International Law Working Group held a first session in Cape Town and on the Blue Train en route to Pretoria from 8 to 11 December 1999. A further session of that Working Group is to be held during the Third Joint Session, to be held in Rome from 20 to 31 March 2000, after which the Report of the Working Group will be considered by the Plenary.

In its preparation of the preliminary draft Convention and the various preliminary draft Protocols thereto, the authors of these texts have at all times striven to avoid entering into conflict with the draft Convention. Evidence of this concern is to be seen in the delimitation of the preliminary draft Convention by reference to interests in mobile equipment protected by registration against identified assets. A decision was taken early on not to go for a debtor-based registration system and not to deal with perfection requirements and priority rules relevant to receivables financing detached from the underlying asset.

The sphere of application of the preliminary draft Convention was from the outset delimited by reference to categories of high-value mobile equipment that were by their nature likely to be moving across or beyond national frontiers on a regular basis in the ordinary course of business and that were capable of unique identification. The view was taken that such a limited coverage might reasonably be expected to make the new international regimen more acceptable to those States for which its innovations might raise the most difficulties. Up until the First Joint Session, held in Rome from 1 to 12 February 1999, the preliminary draft Convention accordingly contained a list of the specific categories of mobile equipment intended to be caught by its provisions (airframes, aircraft engines, helicopters, registered ships - the coverage of which was however only provisional, oil rigs, containers, railway rolling stock, space property) as well as a residual category of "other categories of uniquely identifiable object" (cf. Study LXXII-Doc. 42, Article 3 (a)-(i)).

It is true that this list no longer features in the preliminary draft Convention and it is the considered opinion of the Unidroit Secretariat that therein lies the cause of some of the past difficulties encountered by members of the UNCITRAL Working Group in envisaging the exclusion from the draft Convention of the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of mobile equipment encompassed by the preliminary draft Convention. Paragraph 85 of the Report by the Working Group (A/CN.9/466) gives the distinct impression that it was essentially the prospect of the potentially infinite scope of such an exclusion, opened up by the decision of the First Joint Session to delete the aforesaid list from the preliminary draft Convention, which had made it most difficult for the Working Group to agree to such an exclusion. For this reason, the Unidroit Secretariat intends to propose to the forthcoming Third Joint Session that it reintroduce the list deleted at the First Joint Session.

In these circumstances and on this basis, the Unidroit Secretariat's preferred solution would be that the draft Convention specifically exclude from its sphere of application the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of mobile equipment encompassed by the preliminary draft Convention. The different categories of mobile equipment which it contemplates are of a kind traditionally recognised as enjoying special status. Various aspects of the structure of the proposed new international regimen correspond to the specificity of the categories of equipment covered. Firstly, each category of equipment covered by the preliminary draft Convention will be the subject of a separate Protocol, which will contain those rules that are necessary to adapt the general rules of the preliminary draft Convention to the special characteristics particular to the financing of each such category. Secondly, for the registration of each category of equipment and the establishment of priority ranking as between each such registration a separate International Registry will be created. An insistence on the specificity of the assets covered by the proposed new international regimen has been a recurring feature of Unidroit's work on this project to date.

Independently of the foregoing, the aviation working group, the rail working group and the space working group respectively have all called for an exclusion from the sphere of application of the draft Convention of the assignment of receivables to the extent that the receivables become associated rights in connection with the financing of those categories of aircraft equipment, railway rolling stock and space property encompassed by the preliminary draft Convention as implemented by Protocols thereto. Those groups have been established under the authority of Unidroit in order to monitor the application of the preliminary draft Convention to aircraft equipment, railway rolling stock and space

property and to act as a conduit for the expertise of each sector. They are made up of representatives of manufacturers, users and financiers as well as of the international organisations concerned.

The aviation, rail and space working groups have all enunciated a clear desire that assignments of receivables taken as security in aircraft, rail and space financing transactions should be dealt with in equipment-specific instruments, namely the preliminary draft Convention as implemented by the relevant preliminary draft Protocol, rather than in the draft Convention. The aviation working group in particular emphasised the strong interest of the aviation industry in establishing a single regimen that reflected aircraft financing practices and structures.

The value of assets like aircraft equipment, railway rolling stock and space property lies in the income that may be realised from the sale or lease thereof. It would undermine the concept underlying the preliminary draft Convention if the debtor could assign receivables derived from such an asset under a system different from that applicable to the pledging or other encumbering of the asset. The indivisibility of the asset and the income that may be realised from the sale or lease thereof is clearly enshrined in Articles 8 (1) and 10 of the preliminary draft Convention, relating to rights on default, and Article 14, relating to interim relief.

In the case of aircraft, rail and space financing structures there is an inextricable link between the aircraft equipment, railway rolling stock and space property, on the one hand, and the associated receivables, on the other. In the case of space financing structures, for instance, much of the value placed on a satellite is derived from the various rights associated with the operation of that satellite, in particular the associated receivables. Such rights are an essential element of the commercial value of a satellite and without such rights the satellite will have very little commercial value. It is, therefore, appropriate for security rights relating to both the asset and the associated receivables to be subject to a common regimen, in the interest of avoiding not only conflict of laws problems but also the resultant lack of commercial predictability and increases in transaction costs.

Against the alternative solution, which would consist in allowing the preliminary draft Convention and the various preliminary draft Protocols thereto to supersede the draft Convention, the aviation working group noted the following disadvantages:

> "(1) Many national legal systems, which include aircraft-specific legislation, currently contain assignment rules that are more in line with aircraft financing practices than those proposed in the [draft] Convention. There is no need to disrupt such national legal systems that work well for aircraft financing unless the resulting changes are specifically designed with aircraft financing requirements in mind.
>
> "(2) As the [preliminary draft Convention] may be adopted subsequently, unsatisfactory rules may be applicable to transactions entered into in the interim. That being the case, the finalisation and ratification processes relating to the [draft] Convention may be complicated/delayed by virtue of aviation-related objections and/or the need for further national and international consultations.
>
> "(3) The suggested approach raises rather than resolves potential problems associated with sphere and temporal applications of the two instruments. Commercial predictability will decrease, resulting in increased transaction costs.

"(4) Such an approach would not address the potential conflict between the [draft] Convention and the Geneva Convention [on the International Recognition of Rights in Aircraft]."

In this connection, it is worth noting that the preliminary draft Convention/preliminary draft Aircraft Protocol contain detailed provisions dealing with the co-ordination between the last two texts and the Geneva Convention. The first three disadvantages would be equally true for railway rolling stock and space property.

Should the Commission not feel able to accede to the Unidroit Secretariat's preferred solution, set forth above, for an exclusion from the sphere of application of the draft Convention of the assignment of receivables to the extent that these become associated rights in connection with the financing of all those categories of mobile equipment encompassed by the preliminary draft Convention, the Unidroit Secretariat would propose that it nevertheless accede to the clear desire expressed by the aviation, rail and space working groups for an exclusion of the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of aircraft equipment, railway rolling stock and space property encompassed by the future Unidroit Convention as implemented by Protocols thereto.

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