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RECEIVABLES FINANCING

Analytical Commentary to the draft Convention on Assignment

[in Receivables Financing] [of Receivables in International Trade]

Note by the Secretariat

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V.00-52026 (E)

INTRODUCTION

1. The United Nations Commission on International Trade Law (UNCITRAL), at its twenty-eighth session, in 1995, decided to entrust the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing. 1/ The Commission, at that session, had before it a report of the Secretary-General entitled "Assignment in receivables financing: discussion and preliminary draft of uniform rules" (A/CN.9/412). It was agreed that the report, setting forth the concerns and

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1/ Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 374-381.

the purposes underlying the project and the possible contents of the uniform law, would provide a useful basis for the deliberations of the Working Group. 2/

2. The Working Group commenced its work at its twenty-fourth session, in November 1995, by considering the report of the Secretary-General. 3/ At its twenty-fifth to thirty-first sessions, the Working Group considered revised draft articles prepared by the Secretariat, 4/ and, at its twenty-ninth to thirty-first sessions, it adopted a draft Convention, the exact title of which remains to be determined. 5/ At its thirty-first session, the Working Group had before it a preliminary commentary on the draft Convention prepared by the Secretariat. 6/ At that session, the Working Group agreed that the Secretariat would finalize and distribute the commentary with a view to assisting the Commission in reviewing and finalizing the draft Convention at its thirty-third session, to be held in New York from 12 June to 7 July 2000. 7/

3. The present note has been prepared pursuant to that agreement of the Working Group. It is intended to provide a summary of the reasons for the adoption of a certain provision and its main objectives, along with explanations and interpretations of particular terms, without, however, giving a complete account of the *travaux préparatoires* or of all proposals and provisions that were not retained. For the benefit of those seeking fuller information on the history of a given provision, the commentary lists the references to the relevant portions of the reports of the eight sessions of the Working Group. 8/ After finalization of the draft Convention, the Commission may wish to request the Secretariat to prepare the final version of the commentary, which would serve as an unofficial legislative guide and a tool for interpretation.

2/ Ibid., para. 379. At its twenty-sixth and twenty-seventh sessions, the Commission had considered two other reports of the Secretary-General (A/CN.9/378/Add.3 and A/CN.9/397). For the Commission's discussion of those reports, see ibid., Forty-eighth Session, Supplement No. 17 (A/48/17), paras. 297-30,1 and Forty-ninth Session, Supplement No. 17 (A/49/17), paras. 208-214, respectively.

3/ The report of the Working Group is contained in document A/CN.9/420.

4/ The draft articles prepared by the Secretariat are contained in documents A/CN.9/WG.II/WP.87, A/CN.9/WG.II/WP.89, A/CN.9/WG.II/WP.93, A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98, A/CN.9/WG.II/WP.102 and A/CN.9/WG.II/WP.104. The reports of the Working Group are contained in documents A/CN.9/420, A/CN.9/432, A/CN.9/434, A/CN.9/445, A/CN.9/447, A/CN.9/455, A/CN.9/456 and A/CN.9/466.

5/ A/CN.9/455, para. 17; A/CN.9/456, para. 18; and A/CN.9/466, para. 19.

6/ A/CN.9/WG.II/WP.105 and A/CN.9/WG.II/WP.106.

7/ A/CN.9/466, para. 215.

8/ In order to avoid confusion, no special reference is made to previous article numbers, which, in the course of the preparation of the draft Convention, were altered several times. However, any earlier number will be apparent from the relevant discussion in the reports of the Working Group. Annex II to A/CN.9/466 contains an index to the final renumbering of articles.

ANALYTICAL COMMENTARY

Draft Convention on Assignment
[in Receivables Financing] [of Receivables in International Trade]]

Preamble

The Contracting States,

Reaffirming their conviction that international trade on the basis of equality and mutual benefit is an important element in the promotion of friendly relations among States,

Considering [that] problems created by [the] uncertainties as to the content and choice of legal regime applicable to assignments [of receivables] in international trade [constitute an obstacle to financing transactions],

Desiring to establish principles and adopt rules [relating to the assignment of receivables] that would create certainty and transparency and promote modernization of law relating to [assignments of receivables] [receivables financing] [including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing,] while protecting existing [financing] [assignment] practices and facilitating the development of new practices,

Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

Being of the opinion that the adoption of uniform rules governing assignments [in] [of] receivables [financing] would facilitate the development of international trade and promote the availability of [capital and] credit at more affordable rates,

Have agreed as follows:

References

A/CN.9/420, paras. 14-18
A/CN.9/434, paras. 14-16
A/CN.9/445, paras. 120-124
A/CN.9/455, paras. 157-159
A/CN.9/456, paras. 19-21 and 60-65

Commentary

Title

4. The Commission may wish to consider whether the reference to receivables financing or to international trade should be retained in the title of the draft Convention (for a non-exhaustive list and a brief description of the practices covered by the draft Convention, see paras. 6-12). A reference to financing could be misleading in that it could give the impression that the scope of the draft Convention is limited to purely financing transactions, excluding important service transactions (e.g. assignments in international factoring transactions in which insurance against debtor-default, book-keeping or collection services is provided; chapter I does not exclude such transactions in that it does not refer to the financing purpose or context of the assignment; see para. 25). A reference to international trade may sufficiently reflect the overall objective of the draft Convention to facilitate the movement of goods and services across borders and appropriately clarify that the draft Convention applies to assignments with an international and commercial element, without attempting

to regulate consumer assignments or domestic assignments of domestic receivables. On the other hand, such a reference to international trade may inadvertently give the impression that the draft Convention applies only to assignments of receivables generated in international trade and not to the assignment of consumer receivables; the international assignment of domestic receivables; or the assignment of receivables arising from loan or other transactions that may not involve the sale of goods or the provision of services. In addition, such a reference might fail to reflect the fact that the draft Convention might affect domestic assignments of domestic receivables, for example, in that it is intended to provide which law applies to a conflict between a domestic and a foreign assignee of domestic receivables (on this matter, see also paras. 21 and 169). On balance, it may be preferable to include a reference to international trade in the title and to explain the matter in the commentary.

Preamble

5. The preamble is intended to serve as a statement of the general principles on which the draft Convention is based and which, under article 8, may be used to fill gaps left in the draft Convention. These principles include the facilitation of both commercial and consumer credit at more affordable rates, which is in the interest of all parties involved, assignors, assignees and debtors; the principle of debtor protection, according to which the debtor's legal position is not affected unless expressly stated otherwise in the draft Convention; the promotion of the movement of goods and services across borders; the enhancement of certainty and predictability as to the rights of parties involved in assignment-related transactions; the modernization and harmonization of domestic and international laws on assignment, both at the substantive and the private international law level; the facilitation of new practices and the avoidance of interference with current practices; the avoidance of interference with competition. As to the reference to financing, which appears in the preamble within square brackets, the Commission may wish to consider retaining it, since it could usefully clarify the main objectives of the draft Convention, without limiting the scope of the draft Convention, a matter that could be further explained in the commentary.

Transactions covered

6. In view of the broad definition of a "receivable" in article 2 (a) ("contractual right to payment of a monetary sum"), the draft Convention applies to a wide array of transactions. In particular, the draft Convention covers the assignment of trade receivables (arising from the sale of goods or services between businesses), consumer receivables (arising from consumer transactions), financial receivables (arising from financial transactions, such as loans, deposit accounts, swaps and derivatives) and sovereign receivables (arising from transactions with a governmental authority). With a view to clarifying the context of application of the draft Convention, those practices are described briefly in the following paragraphs. The list of practices cannot be exhaustive, in particular in view of the fact that new practices are rapidly developing which the draft Convention cannot ignore.

7. First of all, included are traditional financing techniques relating to trade receivables, such as factoring (the outright sale of a large number of receivables with or without recourse) and forfaiting (the outright sale of single, large-value receivables, whether they are documentary or not, without recourse). In these types of transactions, assignors assign to financiers their rights in receivables arising from the sale of the assignors' goods or services. The assignment in such transactions is normally an outright transfer but may also, for various reasons (e.g. stamp duty), be for security purposes. The purchase price is adjusted depending on the risk and the time involved in the collection of the underlying receivable. Beyond their traditional forms, those transactions have developed a number of variants tailored to meet the various needs of parties to international trade transactions. For example, in invoice discounting, there is an outright sale of a large number of receivables without debtor-notification but with full recourse against the assignor in the case of debtor default; in maturity factoring, there is full administration of the sales ledger, collection from debtors and protection against bad debts, but without any financial facility; in international factoring, receivables are assigned to a

factor in the country of the assignor ("export factor") and then from the export factor to another factor in the country of the debtor ("import factor") for collection purposes, while the factors do not have recourse against the assignor in the case of debtor default (non-recourse factoring). All those transactions are covered in the draft Convention regardless of their form.

8. The draft Convention also covers innovative financing techniques, such as securitization and project finance, which may relate to a wide range of receivables, including consumer receivables. In a securitization transaction, an assignor, creating receivables through its own efforts ("originator"), assigns, usually by way of an outright transfer, these receivables to an entity ("special purpose vehicle" or "SPV"), fully owned by the assignor and specially created for the purpose of buying the receivables and paying their price with the money received from investors to whom the SPV sells the receivables or securities backed by the receivables. The segregation of the receivables from the originator's other assets allows the price paid by investors (or the money lent) to be linked to the financial strength of the receivables assigned and not to the creditworthiness of the assignor. It also insulates the receivables from the risk of the insolvency of the originator. Accordingly, the originator may be able to obtain more credit than would be warranted on the basis of its own credit rating. In addition, by gaining access to international securities markets, the originator may be able to obtain credit at a cost that would be lower than the average cost of commercial bank-based credit. In large-scale, revenue-generating infrastructure projects, sponsors raise the initial capital costs by borrowing against the future revenue stream of the project. Thus, hydroelectric dams are financed on the security of the future income flow from electricity fees, telephone systems are paid for by the future revenues from telecommunications charges and highways are constructed with funds raised through the assignment of future toll-road receipts. Given the draft Convention's applicability to future receivables, these types of project finance may be reduced to transfers, usually for purposes of security, of the future receivables to be generated by the project being financed. In this context, it should be emphasized that the draft Convention's exclusion of assignments made for personal, family or household purposes will not act to exclude consumer receivables.

9. Many other forms of traditional transactions relating to the assignment of a receivable generated in the context of a financial transaction will also be covered. These include the opening of a credit line on the security of the balance in a deposit account; the refinancing of loans for improving capital to obligations ratio or for portfolio diversification purposes; the assignment of the insurance company's contingent obligation to pay upon loss; and the assignment of rights arising under a letter of credit. Also covered are less traditional transactions, such as loan syndications and participations, swaps and other derivatives, repurchase agreements ("repos") and interbank payments.

10. A "swap" is a transaction in which two parties agree to exchange one stream of obligations for another. The first swaps related to interest payments involved currencies, commodities, energy and credit obligations, and the range continues to expand. The underlying rationale for entering into a swap is to transfer the risks involved with a particular obligation to another party better able or willing to manage them. In a traditional interest swap, a creditworthy entity borrowing money at a fixed interest rate exchanges that interest with a variable interest rate at which a less secure entity borrows a similar sum. As a result, a less creditworthy entity, for a fee, in effect borrows money at a fixed rate. No payment of capital occurs between the parties to the swap (that comes from the underlying loan transactions). Between such parties, only interest payments take place. In practice, the interest payments are offset against each other and only a net payment is made by the party with the larger payment due. This residual payment is a contractual right to a monetary sum and is, therefore, within the broad definition of article 2. There are several variations of a simple interest rate swap. For example, an investor may buy a fixed rate bond and swap the fixed rate for a floating rate from a bank; the bank may take security over the bond to secure the investor's obligations to pay amounts equal to the fixed rate.

11. Derivatives are a more general class of transaction of which swaps are a specific instance. They share the common characteristic of creating payment obligations that are determined by the price of an underlying transaction (this is why they are described as being "derived" from those transactions). With the exception of

interest swaps, most derivative contracts relate to the difference between the agreed future price of an asset on a future date and the actual market price on that date. For example, in a futures contract, one party agrees to deliver to the other party on a specified future date ("the maturity date") a specified asset (e.g. a commodity, currency, a debt, equity security or basket of securities, a bank deposit or any other category of property) at a price agreed at the time of the contract and payable on the maturity date. Futures are usually performed by the payment of the difference between the price agreed upon at the time of the contract and the market price on the maturity date, and not by physical delivery and payment in full on that date (they are called derivatives because settlement is not by actual performance of the sale or deposit contract but by a difference payment derived from an actual asset and an actual price; the contract is derived from an ordinary commercial contract). In options, the buyer has the right (but not the obligation) to acquire ("call option") or to sell ("put option") an asset in the future at a price fixed when the option is entered into. Repurchase agreements (or repos) are contracts under which one party sells a (usually fixed interest) security to another and simultaneously agrees to repurchase the security at a future date at an agreed price that includes allowance for the interest on the cash consideration and the accrued interest on the security. The payments are contingent upon the delivery or return of security. Within inter-bank payment systems and securities settlement systems, participants have obligations to make a large number of individual payments and also rights to receive similar numbers of payments from other participants. These obligations and rights are resolved into payments due to or from the system as a whole (typically using a central counter-party) or due between each pair of participants.

12. Derivatives, including swaps and repos, are usually transacted within a master netting agreement (e.g. the Master Netting Agreement prepared by the International Swaps and Derivatives Association ("ISDA")), which provides for the net settlement of payments due in the same currency on the same date. The agreement may also make provision, upon the default by a party, for the termination of all outstanding transactions at their replacement or fair market cost, conversion of such sums into a single currency and netting into a single payment by one party to the other (issues relating to netting are addressed in the ISDA Model Netting Act, adopted by 21 States). Set off (the discharge of reciprocal claims to the extent of the smaller claim) and netting (at its simplest, the ability to set off reciprocal claims on the insolvency of a counter-party) may come within the ambit of the draft Convention to the extent that the net obligation arising under a derivatives contract may be assigned.

CHAPTER I. SCOPE OF APPLICATION

Commentary

Structure of chapter I

13. In chapter I, scope-related issues are dealt with in different provisions for the sake of clarity and simplicity in the text. Article 1 defines the substantive scope in general terms, as well as the territorial scope of application of the draft Convention. Articles 2 and 3 define the substantive scope in more detailed terms (definitions of assignment, receivable and internationality of an assignment or a receivable). Articles 4 and 5 deal with excluded transactions and transactions treated differently. Article 6 appears in chapter II of the draft Convention since the terms defined therein do not raise mainly or only scope-related issues. The Commission may wish, however, to consider whether, in view of the importance of the term "location", its definition in article 6 (i) should be moved to article 2 or 3 or to a new article in chapter I.

Article 1. Scope of application

(1) This Convention applies to:

(a) Assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State;

(b) Subsequent assignments provided that any prior assignment is governed by this Convention; and

(c) Subsequent assignments that are governed by this Convention under subparagraph (a) of this paragraph, notwithstanding that any prior assignment is not governed by this Convention.

(2) This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

[(3) The provisions of chapter V apply to assignments of international receivables and to international assignments of receivables as defined in this chapter independently of paragraphs (1) and (2) of this article. However, those provisions do not apply if a State makes a declaration under article 37.]

(4) The annex to this Convention applies in a Contracting State which has made a declaration under article 40.

References

A/CN.9/420, paras. 19-32
A/CN.9/432, paras. 13-38
A/CN.9/434, paras. 17-41
A/CN.9/445, paras. 45-48 and 125-145
A/CN.9/447, paras. 143-146
A/CN.9/455, paras. 41-46 and 160-173
A/CN.9/456, paras. 22-37
A/CN.9/466, paras. 145-149

Commentary

Substantive and territorial scope of application

14. Under article 1, the draft Convention applies to assignments of receivables (for a definition of the terms “assignment” and “receivable”, see paras. 26, 27, 29 and 30). There are two conditions for the draft Convention to apply. There needs to be an element of internationality (for an exception, see para. 18) and an element of a territorial connection between certain parties and a Contracting State. The element of internationality may relate to the assignment or to the receivable. Accordingly, the draft Convention applies to assignments of international receivables, whether or not the assignments are international or domestic, and to international assignments of receivables, even if the receivables are domestic. As a result, the assignment of receivables is covered whether or not those receivables arise in the context of international or domestic trade, as long as the assignment itself is international (for comments on internationality, see paras. 38-40). The element of territorial connection may relate to the assignor only or to the assignor and the debtor. For the application of the provisions of the draft Convention other than the debtor-related provisions (e.g. chapter IV, section II), only the assignor needs to be located in a Contracting State. For the application of the draft Convention as a whole, the debtor too needs to be located in a Contracting State (or the law governing the receivable needs to be the law of a Contracting State; for a discussion of the term “location”, see paras. 66-70).

15. This approach to the issue of the territorial scope of the draft Convention is based on the assumption that the main disputes that the draft Convention would be called upon to resolve would be addressed if the assignor (and, only for the application of the debtor-related provisions, the debtor too) is located in a Contracting State. Such disputes could arise with regard to rights of the assignee against the assignor flowing from the breach of a warranty; enforcement of the receivables by the assignee against the debtor; discharge of

the debtor; defences of the debtor towards the assignee; relative rights of the assignee and the administrator in the insolvency of the assignor; relative priority rights of the assignee and a competing assignee; and the effectiveness of subsequent assignments. The Working Group also considered that enforcement would normally be sought in the place of the assignor's or the debtor's location and there is thus no need to make reference to the assignee's location; and that application of the provisions of the draft Convention other than those contained in section II of chapter IV would not affect the debtor and there is thus no need to preclude the application of all the provisions of the draft Convention if the debtor is not located in a Contracting State.

16. As a result of this approach, the territorial scope of application of the draft Convention is sufficiently broad and thus it is not necessary to extend it to cases in which no party may be located in a Contracting State but the law of a Contracting State is applicable by virtue of the private international law rules of the forum. The Working Group thought that such an approach might introduce uncertainty, at least, to the extent that private international law on assignment is not uniform and, in any case, parties would not know at the time of the conclusion of a transaction where a dispute might arise and, as a result, which private international law rules might apply. However, if the forum is located in a non-Contracting State, the courts are not bound by the draft Convention. Therefore, despite the fact that article 1 does not refer to the application of the draft Convention by virtue of private international law rules, the courts of a non-Contracting State may not be precluded from applying the draft Convention as part of the law designated by their private international law rules. In this connection, the particular question arises as to whether the courts of a non-Contracting State would apply the draft Convention only if the courts of a Contracting State would apply it (i.e. if the substantive and territorial requirements of the draft Convention are met) or even if the courts of a Contracting State would not apply it (i.e. if the requirements of chapter I are not met). The Commission may wish to address this question.

17. Under article 1 (2), the debtor-related provisions of the draft Convention may apply to situations in which the debtor might not be located in a Contracting State but the law of a Contracting State governs the assigned receivable. In this context, a different approach to the territorial scope of application of the draft Convention is followed, since the Working Group felt that certainty as to the application of the draft Convention would not be unduly compromised. Furthermore, unlike paragraph (1), paragraph (2) of article 1 does not specify the time at which the debtor needs to be located in a Contracting State or the receivable needs to be governed by the law of a Contracting State (on this matter, see also paras. 202 and 219). The Commission may wish to specify that time. The time of the conclusion of the original contract may be preferable from a debtor protection point of view, since it would enhance predictability of the application of the draft Convention to the debtor-related issues. Such an approach would also be consistent with article 39, which refers to the location of the debtor in a State making a declaration at the time of the original contract. However, such an approach would result in the assignor, the assignee and third parties not being able to determine, in the case of future receivables, whether the draft Convention would apply to the rights and obligations of the debtor (for a related problem with regard to future receivables assigned domestically, see paras. 39 and 40).

Subsequent assignments

18. In line with the principle of *continuatio juris*, the draft Convention applies also to subsequent assignments made, for example, in the context of international factoring, securitization and refinancing transactions, provided that any prior assignment is governed by the draft Convention (and irrespective of whether there is an element of internationality). Accordingly, even a domestic assignment of domestic receivables may be brought into the ambit of the draft Convention if it is subsequent to an international assignment. The reason for such an approach is that, unless all assignments in a chain of assignments were made subject to one and the same legal regime, it would be very difficult to address assignment-related issues

in a consistent manner. The Commission may wish to consider whether the draft Convention should apply to subsequent assignments only if the assignor is located in a Contracting State.

19. The draft Convention also applies to subsequent assignments that in themselves fall under article 1 (a), whether or not any prior assignment is governed by the draft Convention (as this is not a separate type of assignment, the Commission may wish to reconsider the placement of article 1 (1) (c)). As a result, the draft Convention may apply only to some of the assignments in a chain of assignments. This result is a departure from the principle of *continuatio juris*. However, the Working Group considered it necessary to follow this approach since parties to assignments in securitization transactions, in which the first assignment is a domestic one and relates to domestic receivables, should not be deprived of the benefits that may be derived from the application of the draft Convention. This approach is based on the assumption that it would not unduly interfere with domestic practices (on this matter, see para. 20).

Relationship with national law

20. As a result of covering in the draft Convention international assignments of domestic receivables or even domestic assignments of domestic receivables made in the context of subsequent assignments, business parties in domestic transactions could benefit from increased access to international financial markets and thus to potentially lower-cost credit. The interests of assignors, protected, for example, by national law prohibitions of assignments of future receivables or of global assignments, would not be unduly interfered with to the extent that the draft Convention does not preclude the assignor from offering its receivables to different lenders for credit (e.g. to a supplier of materials on credit and to a financing institution for working capital) in that it does not give priority to one over the other. The interests of debtors, protected by national legislation, would not be unduly interfered with either, at least to the extent that the draft Convention requires that the debtor be located in a Contracting State and limits the effects of an assignment on the debtor to mainly payment to another creditor in the country and in the currency stipulated in the original contract. The interests of domestic assignees would not be unduly interfered with either, because the draft Convention does not give priority to a foreign over a domestic assignee. It merely specifies which national law would govern priority. In addition, for a conflict between a domestic and a foreign assignee to be covered by the draft Convention (article 24 (a) (i)), the assignor would need to be located in a Contracting State (article 1 (a)) and that State, by definition in a domestic assignment of a domestic receivable (article 3), would be the State in which both the domestic debtor and the domestic assignee would be located. However, as a result of the central-administration location rule, different laws might apply to a conflict between an assignment by a branch office and an assignment by the head office, if the branch or the head office is not located in a Contracting State.

Scope of chapter V

21. Under article 1 (3), the private international law provisions of chapter V apply to assignments with an international element as defined in article 3, whether or not the assignor or the debtor is located in a Contracting State. The justification for limiting the scope of application of chapter V lies in the wish to reduce any conflicts with other conventions, dealing with private international law issues of assignment (e.g. the European Union Convention on the Law Applicable to Contractual Obligations, Rome, 1980 ("the Rome Convention") and the Inter-American Convention on the Law Applicable to International Contracts, Mexico City, 1994 ("the Mexico City Convention")). The Commission may wish to reconsider this approach. Defining the scope of application of private international law provisions by reference to substantive or even artificial notions of internationality would not appear to be appropriate. In any case, the question of conflicts with other private international law texts is already sufficiently addressed in articles 36 (giving precedence to any other international legislative text that deals with the same matters) and 37 (allowing States to opt out of chapter V).

22. The Commission may also wish to consider dealing with the issue of the hierarchy between the substantive and the private international law provisions of the draft Convention with a view to ensuring that the substantive law provisions apply first (the matter is addressed in article 24 by the words " with the exception of matters which are settled elsewhere in this Convention"). A new provision could be inserted at the beginning of chapter V that would deal with the scope of chapter V, the hierarchy between chapter V and the rest of the draft Convention and with the right of States to opt out of chapter V. Such a provision could read along the following lines: "Chapter V applies to assignments independently of the provisions of chapter I. In the case of an assignment to which this Convention applies in accordance with chapter I, chapter V applies to matters that are not settled elsewhere in this Convention. If a State makes a declaration under article 37, chapter V does not apply." Article 37 would serve to explain the effect of such a declaration (for further comments on the scope and purpose of chapter V, see paras. 187-189). If such an approach were to be followed, article 1 (3) could be deleted or refer only to the possibility for a reservation by States with respect to the application of chapter V.

Application of the annex

23. Article 24 of the draft Convention refers priority issues to the law of the assignor's location (as to the meaning of "location", see article 6 (i)). In recognition of the fact that some States may need to modernize or adjust their priority rules, article 1 (4) allows States to opt into one of the two substantive law priority rules set forth in the annex. Article 40 (2) clarifies the effect of a declaration under article 1 (4), namely, that, for the purposes of article 24, the law of the assignor's location is the priority rule of the annex chosen by the Contracting State in which the assignor is located (for the choices given to States and effects of declarations, see para. 216). Once article 40 is finalized, the Commission may wish to reconsider the formulation and the proper place of article 1 (4) in the draft Convention.

Article 2. Assignment of receivables

For the purposes of this Convention:

(a) "assignment" means the transfer by agreement from one person ("assignor") to another person ("assignee") of the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) in the case of an assignment by the initial or any other assignee ("subsequent assignment"), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee.

References

A/CN.9/420, paras. 33-44
A/CN.9/432, paras. 39-69 and 257
A/CN.9/434, paras. 62-77
A/CN.9/445, paras. 146-153
A/CN.9/456, paras. 38-43
A/CN.9/466, paras. 87-91

Commentary

Assignment and contract of assignment or financing contract

24. Like most legal systems, the draft Convention recognizes the distinction between the assignment itself as a transfer of property and the contract of assignment as a transaction creating personal obligations (in other

words, between the assignment and its *causa*, that is, a sale, security agreement, gift or payment). This distinction may be apparent where the contract of assignment and the assignment take place at different points of time and are part of separate agreements (as, e.g., in securitization and project finance transactions). It may not be as apparent where the two transactions take place simultaneously and are embodied in a single contract (as, e.g., in factoring transactions). While the main focus of the draft Convention is on assignment as a transfer of property rights in receivables, the draft Convention deals also with contractual matters in articles 13 to 16 and 28. However, the draft Convention does not address the issue of the relationship between the assignment and the contract of assignment. This relationship is treated differently from one legal system to another. In some legal systems, the effectiveness of an assignment depends on the validity of the contract. In other legal systems, the assignment is treated as an "abstract transaction", that is, legally independent of the underlying contract in the sense that defects in the underlying contract do not automatically affect the validity of the assignment and vice versa. In yet other legal systems, the assignment is a separate act but may be affected by the invalidity of the contract. In practice, a defect in the contract of assignment will often lead to the nullification of the assignment itself. However, in those limited cases in which only the contract may be invalid, the assignor will have only a personal claim against the assignee limited to restitution of any unjust enrichment and will not be able to have the assigned receivable separated from the assignee's insolvency estate or to oppose the attachment of the assigned receivable in the hands of the assignee.

25. In particular, the draft Convention does not refer to the purpose of an assignment, that is whether an assignment is made for purely financing purposes or for book-keeping, collection, insurance, risk-management, portfolio diversification or other purposes. Such qualifications interfere with the purpose of the contract of assignment or the financing contract and would result in: inappropriately limiting the scope of the draft Convention to purely financing transactions and in creating a special regime on assignments for financing purposes, even though one is not needed; uncertainty, since there is no universal understanding of the terms "financing" and "commercial", and a uniform definition is neither feasible nor desirable; and in unnecessarily excluding from the scope of the draft Convention important transactions in which only services may be provided (with regard to the possible impact of such an approach on national law, see para. 20; as to potential conflicts with the Convention on International Factoring, Ottawa, 1980 ("the Ottawa Convention"), see paras. 204-206).

"Transfer by agreement"

26. With the intention of bringing within the ambit of the draft Convention, in addition to assignments, other practices involving the transfer of property rights in receivables, such as contractual subrogation or pledge, article 2 defines "assignment" as a transfer. This approach takes into account the fact that significant receivables financing transactions, such as factoring, take place, in some legal systems, by way of a contractual subrogation or pledge. Rather than creating a new type of assignment, the draft Convention is aimed at providing uniform rules on assignment and assignment-related practices with an international element, which, although covered in theory by currently existing national law, could not be sufficiently developed in view of the inherent limitations on the application of national law to matters of mandatory law in an international context. The reference to transfers "by agreement" is intended to exclude transfers by operation of law (e.g. statutory subrogation).

27. Both outright transfers, including those made for security purposes, and assignments by way of security are intended to be covered, whether "value, credit or services" is given or promised at the time of the assignment or at an earlier time (consideration is not mentioned in article 2, since it is a matter for the contract of assignment or the financing contract). In order to avoid any ambiguity as to whether an assignment by way of security is covered, the matter is addressed explicitly in article 2 (a), which creates the legal fiction that, for the purposes of the draft Convention, the creation of security rights in receivables is deemed to be a transfer. However, the draft Convention does not define outright assignments and assignments by way of security. This matter is left to other law applicable outside the draft Convention, since, in view of the wide divergences

existing among legal systems as to the classification of transfers, an assignment by way of security could in fact possess attributes of a sale, while a sale might be used as a security device.

"From one person to another person"

28. Both the assignor and the assignee can be legal entities or individuals, whether merchants or consumers. In particular, the assignment between individuals is covered, unless the assignee is a consumer and the assignment is made for his/her own consumer purposes (article 4 (1) (a)). As a result, the assignment of credit card receivables or of loans secured by real estate in securitization transactions and of toll-road receipts in project financing arrangements fall within the ambit of the draft Convention. In view of the fact that in the draft Convention the singular includes the plural and vice versa, an assignment made by many persons (e.g. joint owners of receivables) or to many persons (e.g. a syndicate of financiers) is also covered (so is the assignment of more than one receivable). In the determination, however, of the territorial scope of application or internationality, each assignment should be considered a separate assignment and meet the conditions of chapter I for the draft Convention to apply (as to cases involving multiple debtors, see para. 38). In an assignment to a trustee acting on behalf of several persons, whether there are one or several assignees depends on the exact authority of the trustee, that is, whether the trustee was a mere agent or had the authority to make substantive decisions. This matter is left to law outside the draft Convention.

"Contractual right to payment of a monetary sum"

29. Receivables arising from any type of contract are intended to be covered, whether the contract exists at the time of assignment or not. The transfer of receivables arising by operation of law, such as tort receivables, receivables arising in the context of unjust enrichment, tax receivables or receivables determined in court judgements or arbitral awards, are excluded, unless they are confirmed in a settlement agreement. What is a "contractual" right is a matter of interpretation in accordance with the law governing that right. However, contractual receivables, the assignment of which is covered by the draft Convention, include receivables arising under contracts for the sale of goods or the provision of services, whether those contracts are commercial or consumer transactions; receivables in the form of royalties arising from the licensing of intellectual property; damages for breach of contract; interest if it was owed under the original contract; dividends arising from shares, whether they were declared at, or arose after, the time of the assignment; the right to receive payment of the proceeds of an independent guarantee or a letter of credit; and receivables in the form of credit balances in deposit accounts or securities transactions.

30. While, in principle, the right of the assignor/seller to any goods returned by the buyer (debtor) is not a receivable under the draft Convention, as between the assignor and the assignee, it is treated as a receivable to the extent that any goods returned by the buyer take the place of the assigned receivable (article 16; but, as against third parties, the assignee does not have a right to any returned goods, since they are excluded from the definition of "proceeds" in article 6 (k)). Furthermore, non-monetary rights convertible into a monetary sum (e.g. the assignment of rights arising in a commodity swap) are receivables the assignment of which is covered. To the extent that the conversion is foreseen in the original contract, this result is implicit in article 2; to the extent that such a conversion is not foreseen in the original contract, it is in line with the Working Group's decision to cover the assignment of non-monetary rights converted into damages for breach of contract. This result is also implicit in article 5, which relates to swaps and derivatives transactions. The Commission may wish to reflect this understanding explicitly in the draft Convention. The Commission may also wish to consider whether unilateral assignments should be covered, although such assignments are rare in practice. In addition, after acceptance of the proceeds of the assigned receivable a de facto assignment would exist. However, in the few situations where a unilateral assignment is made and a conflict arises with a Convention assignment before any implicit agreement by way of the assignee's acceptance of payment, it may be desirable to ensure that the conflict is resolved under article 24 on the basis of the law of the assignor's location.

Non-monetary performance rights

31. The assignment of other, non-monetary, contractual rights (e.g. the right to performance, the right to declare the contract avoided or the right to request delivery of a commodity or a security under a swap or repurchase agreement) or of composite rights (e.g. the right to present documents and demand payment under an independent guarantee or a letter of credit) is not covered. The Commission may wish to reconsider the exclusion of assignment of non-monetary contractual rights to performance. Such an approach may result in parts of one and the same assignment transaction being submitted to different legal regimes, since in practice assignments often relate to all rights arising under a contract and assignees rely on non-monetary performance rights as well (draft article 12.101 of the European Contract Principles refers to "rights to payment or other performance"; 9/ however, draft article 1.1 of the Principles on Assignment of the International Institute for the Unification of Private Law ("Unidroit") is modelled on article 2). 10/ Assignments of contracts, which involve an assignment of contractual rights and a delegation of obligations, are not covered either. While such transactions may form part of financial arrangements, the financier would normally rely mainly on the receivables. As to the delegation of obligations, the Working Group thought that it should not be covered because it raises issues going far beyond the desirable scope of the draft Convention.

Parts or undivided interests in receivables

32. Important practices that are intended to be covered by the draft Convention involve the assignment of parts or undivided interests in receivables (e.g. securitization, loan syndication and participation). The effectiveness of such partial assignments is not common ground in all legal systems. Article 9, therefore, validates such assignments. However, in view of the fact that there is no explicit reference in chapter I to such partial assignments, it is not clear whether the draft Convention as a whole applies to them (including the debtor protection provisions, the application of which is important if the receivable is partially assigned to several assignees and the debtor incurs expenses to pay to more than one person). The Commission may, therefore, wish to clarify this matter in article 2 (a), by adding, for example, before the words "of the assignor's contractual right" the words "all or part" (the matter is addressed in draft article 12.103 of the European Contract Principles and draft article 1.3 Unidroit Principles on Assignment).

33. With regard to monetary rights that are divisible, the debtor will normally be able to make partial payment. This may not be the case with non-monetary performance rights, since dividing performance rights could change the relationship between performance and counter-performance and have a negative impact on the legal position of the debtor. Therefore, if the Commission decides to include assignments of non-monetary performance rights within the ambit of the draft Convention, it may wish to clarify that a partial assignment of such rights is permitted only if they may be divided (e.g. if the debtor is entitled to make a separate payment for the part of the performance assigned; see draft article 12.103 (2) of the European Contract Principles). In addition, the Commission may wish to consider the position of the debtor in the case of a partial assignment of a monetary receivable. In practice, creditors are interested in a normal flow of payments and it is, therefore, unlikely that a debtor would be requested to pay more than one assignee. In addition, under article 17, such a request could only involve different payees in the same country and could not result in any additional cost to the debtor.

9/ Reference is made to the draft available in December 1999, prepared for the Commission on European Contract Law by Professor Roy Goode.

10/ Reference is made to Unidroit 1999, Study L - Doc.65 of December 1999, Working Group for the preparation of Principles on International Commercial Contracts, Chapter [...], Assignment of rights, transfer of duties and assignment of contracts, Section I: assignment of rights (draft and explanatory notes prepared by Professor Marcel Fontaine).

34. However, the matter may need to be addressed explicitly. The Commission may wish to consider, for example, that, at the discretion of the debtor, a notification should be treated as ineffective if the related payment instruction instructs the debtor to pay to a designated payee less than the amount due under the original contract. Such an approach would result in covering all combinations of single or multiple assignments of parts or undivided interests in receivables, whether they involve lump-sum or periodic payments. It would also result in protecting the debtor in a sufficient but flexible way, without prescribing, in a regulatory manner, what the assignor, the debtor or the assignee ought to do and without creating liability. If the debtor is prepared to comply with an instruction to pay multiple assignees, there is no reason to prevent parties from doing what they all want to do. On the other hand, if the debtor pays while being unaware of its right to ignore such a payment instruction, the optional character of the ineffectiveness of the notification would preserve the *pro tanto* discharge of the debtor as a result of the payment in accordance with payment instructions. Alternatively, in the case of a partial assignment, the identification of a single payee could be made a condition of the effectiveness of a notification and the related payment instruction. In such a case, if the debtor is faced with instructions to pay more than one assignee of parts of a receivable, the debtor could be allowed to obtain a discharge by paying the assignor or the first assignee to notify (additional wording may need to be included in articles 18 and 19). A third alternative may be to establish the debtor's right to seek from the assignor compensation of any additional costs incurred by the debtor as a result of a partial assignment or even a right of set-off against the assignee. In cases where a right to compensation may not adequately protect the debtor against exposure to separate proceedings commenced by the assignor and one or more assignees, the debtor may be given a right to apply for an order for all claimants to be joined in one proceeding, in which a decision will be binding to all (draft article 12.103 (3) and (4) of the European Contract Principles).

Personal rights/statutory assignability

35. Article 2 does not refer to personal rights that by law are not assignable (e.g. wages, pensions, insurance policies and sovereign receivables). It is assumed, however, that statutory limitations on assignment, other than those addressed in article 9, are not intended to be covered (see paras. 84 and 85). The Commission may wish to state this understanding explicitly in article 2 (draft article 12.302 of the European Contract Principles refers to "a performance which the debtor, by reason of the nature of the performance or the relationship of the debtor and the assignor, could not reasonably be required to render to anyone except the assignor"; and draft article 1.3 of the Unidroit Principles on Assignment refers to rights that have "a personal character or the assignment [of which] is prohibited by the applicable law").

"[Owed by] a third person"

36. Apart from the assignor and the assignee, the debtor too could be a legal entity or an individual, a merchant or a consumer, a governmental authority or financial institution (or there could be a multiplicity of debtors). Unlike the Ottawa Convention, the draft Convention does not exclude commercial practices involving the assignment of contractual receivables owed by consumers, unless the assignment is to a consumer for his/her consumer purposes (articles 4 (1) (a)). Assignments of consumer receivables form part of significant practices, such as securitization of credit card receivables, the facilitation of which has the potential to increase access to lower-cost credit by manufacturers, retailers and consumers and, as a result, could facilitate international trade in consumer goods. However, while covering the assignment of consumer receivables, the draft Convention is not intended to override consumer-protection law. This principle flows from the general debtor protection principle enshrined in article 17 (1). It is also reflected in a number of provisions of the draft Convention, as, for example, in articles 21 (1) and 23, under which a consumer-debtor cannot waive any defences and rights of set-off and has a right to recover payments from the assignee, if the consumer protection law applicable in the country of the debtor so provides (for anti-assignment clauses in a consumer context, see para. 100).

37. The assignment of receivables owed by a Government or a public entity is covered, unless they are unassignable by law (a matter that may need to be explicitly clarified; as to statutory limitations, see paras. 84 and 85). However, the State in which the sovereign debtor is located may enter a reservation as to the rule of article 11 that assignments are effective notwithstanding a contractual limitation on assignment (see paras. 213 and 214). Receivables owed by debtors in financial contracts, such as loans, deposit accounts, swaps and derivatives, are also covered by the draft Convention. However, the effectiveness of an assignment in general or only as to the debtor of such a receivable may be left to law outside the draft Convention (article 5). Furthermore, the assignment of one or more than one receivable, whether in whole or in part, owed jointly (i.e. fully) and severally (i.e. independently) by multiple debtors is also covered, provided that the contract from which the assigned receivables arise (hereinafter referred to as "the original contract") is governed by the law of a Contracting State. If, however, the original contract is not governed by the law of a Contracting State and one or more, but not all, debtors are located in a Contracting State, each transaction should be viewed as an independent transaction and thus debtors who are not located in a Contracting State should not be affected by the draft Convention. Otherwise, the predictability as regards the application of the draft Convention to rights and obligations of debtors, which is one of the main objectives of the draft Convention, could be compromised.

Article 3. Internationality

A receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different States. An assignment is international if, at the time of the conclusion of the contract of assignment, the assignor and the assignee are located in different States.

References

A/CN.9/420, paras. 26-29
A/CN.9/432, paras. 19-25
A/CN.9/445, paras. 154-167
A/CN.9/456, paras. 44, 45, 227 and 228
A/CN.9/466, paras. 92 and 93

Commentary

38. With a view to achieving certainty in the application of the draft Convention, article 3, following the example of other texts prepared by UNCITRAL or other organizations, defines internationality by reference to the location of the parties (under article 6 (i), "location" means place of business or, in the case of more than one place of business of the assignor and the assignee, the place of central administration or, in the case of no place of business, the habitual residence). In the case of more than one assignor, assignee or debtor, internationality is to be determined for each of those parties separately (see paras. 28 and 37). As a result of article 3, once a receivable is international, its assignment is covered by the draft Convention, whether the receivable is assigned to a domestic or to a foreign assignee. On the other hand, even if a receivable is domestic, its assignment may come within the ambit of the draft Convention if it is international or it is part of a chain of assignments that includes an earlier international assignment (see para. 19).

39. The international character of an assignment is determined at the time it is made, while internationality of a receivable is determined at the time of the conclusion of the original contract ("at the time it arises"). Determining the internationality of a receivable at the time it arises is justified by the need for a potential assignor to know at the time of the conclusion of the original contract which law might apply to a potential assignment. Such knowledge is important for a potential assignor to be able to determine whether and at what cost the assignor may obtain credit and, on that basis, to decide whether to extend credit to the debtor and on what terms. As a result of this approach to the relevant time for determining internationality, however, in the case of a domestic bulk assignment of domestic and international future receivables, the parties may not be able to predict at the time of the assignment whether the draft Convention will apply (this problem would not arise,

however, in the case of international assignments of domestic or international receivables, since the internationality of an assignment could be determined at the time it is made). Furthermore, in the case of a domestic assignment of both domestic and international receivables, the draft Convention would apply to the assignment of the international receivables but not to the assignment of the domestic receivables. This means that, depending on whether the draft Convention applies, implied representations as between the assignor and the assignee, as well as the legal position of the debtor may be different (e.g. as to defences and rights set-off, but not as to discharge, since the debtor may discharge under law applicable outside the draft Convention). However, the applicable priority rules would not be different, since the draft Convention would cover in any case all possible conflicts of priority, including conflicts with a domestic assignee of domestic receivables.

40. Parties to domestic assignments will, therefore, need to structure their transactions in a certain way to avoid this problem (e.g. by avoiding to assign in one transaction both domestic and international receivables). Where parties are not able to do so, they will be exposed to the possibility that one law may apply to domestic receivables while another law, the draft Convention, would apply to international receivables. This problem, however, is not created by the draft Convention; it exists already outside the draft Convention in cases where domestic and international receivables are assigned. Furthermore, structuring a transaction under the draft Convention would be easier than under other law, at least, to the extent that parties to a domestic assignment will be faced with only two laws that may possibly apply to their assignment, the law of the country, in which the assignor and the assignee are located, and the draft Convention. In addition, a debtor's legal position would not be changed, unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

Article 4. Exclusions

(1) This Convention does not apply to assignments:

(a) Made to an individual for his or her personal, family or household purposes;

(b) To the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

(c) Made as part of the sale, or change in the ownership or the legal status, of the business out of which the assigned receivables arose.

[(2) This Convention does not apply to assignments listed in a declaration made under article 39 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

References

A/CN.9/432, paras. 18, 47-52, 106 and 234-238
A/CN.9/434, paras. 42-61
A/CN.9/445, paras. 168-179
A/CN.9/456, paras. 46-52
A/CN.9/466, paras. 54-59, 78-86 and 192-195

Commentary

41. In view of the broad scope of application of the draft Convention, article 4 is intended to exclude certain practices that are either distinct from assignment-related practices or are already sufficiently regulated.

Assignments for consumer purposes

42. Subparagraph (a) is intended to exclude from the scope of the draft Convention assignments from a business entity or a consumer to a consumer but only if they are made for the assignee's personal, family or household purposes. The Working Group agreed that such assignments were of no practical significance. As a result, assignments of consumer receivables were not excluded, unless made to a consumer for his/her consumer purposes.

Assignments of negotiable instruments

43. Subparagraph (b) is intended to exclude transfers of negotiable instruments. Such transfers are distinct from assignments and are regulated by specific rules of national and international law (e.g., there is no requirement for the notification of a transfer; if the debtor pays a transferee who is not the holder, the debtor is still liable to the holder; a person who takes the instrument for value and without knowledge of any hidden defences against the transferor is not subject to those defences). Rather than referring to the documentary nature of a receivable, subparagraph (b) focuses on the form of the transfer. Such an approach is sufficient to preserve the negotiability of an instrument, while it avoids the need to define "negotiable instrument", a term on which there is no universal understanding. Excluded are transfers of receivables made by endorsement and delivery or by mere delivery of an instrument. Such instruments include bills of exchange, promissory notes, cheques and bearer documents (e.g. negotiable securities).

44. Receivables arising under a contract are often incorporated into a negotiable instrument for the sole purpose of obtaining payment by way of summary proceedings in court, if necessary. In such cases, both the receivable arising under a contract and the receivable incorporated into a negotiable instrument may be transferred. The words "to the extent made by the delivery ... with any necessary endorsement" are intended to ensure that only the transfer of the receivable in the form of a negotiable instrument and not of the receivable in its contractual form is excluded from the scope of application of the draft Convention. The Commission may wish to consider whether article 4 (b) should refer to transfers of dematerialized (i.e. electronic) negotiable instruments.

Assignments of receivables in corporate buyouts

45. Subparagraph (c) is aimed at excluding assignments made in the context of the sale of a business as a going concern, if they are made from the seller to the buyer. Such assignments are excluded since they are normally regulated differently by national laws dealing with corporate buyouts and are not of a financing nature. However, assignments made to an institution financing the sale are not excluded.

Other types of assignments or receivables

46. In the course of its work, the Working Group considered the exclusion of other types of assignments, such as assignments by operation of law, assignments as gifts, assignments of wages, contractual rights in general, insurance premiums, rights under independent guarantees and letters of credit ("independent undertakings"), assignments of rents from real estate and equipment and assignments of balances in deposit accounts. As to assignments by operation of law, it should be noted that they are excluded in view of the definition of "assignment" by reference to a "transfer by agreement" (article 2 (a)). In view of the fact that consideration was thought to be part of the contract of assignment, which, with the exception of articles 13 to 16 and 28, is not addressed in the draft Convention, the Working Group decided not to address assignments as gifts.

47. As to the assignment of wages (or pensions), the Working Group decided to leave the matter to other law. If such assignments are prohibited under national law, the draft Convention does not affect that prohibition. If, however, such assignments are not prohibited under national law, with a view to preserving

significant practices, such as the financing of temporary employment services, the draft Convention does not do anything to invalidate them. However, that result may not be achieved, unless a specific reference to statutory limitations relating to personal or similar receivables is included in article 9, which validates assignments of future receivables, without any exception as to personal rights that may not be assignable under national law (on this matter, see also paras. 84 and 85).

48. The assignment of the right to present an independent undertaking along with any documents it requires and demand payment is not intended to be covered by the draft Convention (the Commission may wish to state this result explicitly in article 4). However, the assignment of the proceeds of payment of an independent undertaking is covered by the draft Convention, with the additional protection introduced in article 5 for the guarantor/issuer of such an independent undertaking. As to the assignment of receivables arising from the sale or lease of mobile equipment, the Working Group decided that it should not be excluded. Article 36 was thought to be sufficient to address any conflicts with a preliminary draft Convention currently being prepared (see para. 211; as to the assignment of receivables other than trade receivables, see paras. 50-54). In order to reduce the potential for such conflicts, the Commission may wish to consider whether the assignment of receivables arising from the sale or lease of high-value mobile equipment should be treated in the same way as assignments of receivables other than trade receivables (i.e. whether contractual limitations on assignment need to be given effect to the extent of invalidating the assignment in general or only as against the debtor). Article 12 (5) would be sufficient to preserve any form or registration requirements relating to security and other supporting rights in high-value mobile equipment and article 24 would be sufficient to ensure that any conflicts of priority would be subject to the preliminary draft Convention if the assignor is located in a State party to the preliminary draft Convention.

49. In the interest of enhancing the acceptability of the draft Convention, paragraph (2), which appears within square brackets since it has not been adopted yet by the Working Group, is intended to ensure that States are given the option to exclude further practices. Such an approach may be necessary if no agreement is reached on the practices to be excluded in paragraph (1) or in order to address concerns that might arise in the future. However, a possible disadvantage of such an approach would be that the scope of the draft Convention could vary from State to State, with the result that, in view of the multiplicity of parties involved and the possibility that one or more but not all potentially relevant States might have made a declaration, the exact scope of the draft Convention would not be easy to ascertain.

[*Article 5. Limitations on [assignments of] receivables other than trade receivables*

Variant A

(1) Articles 17, 18, 19, 20 and 22 do not affect the rights and obligations of the debtor in respect of a receivable other than a trade receivable except to the extent the debtor consents.

(2) Notwithstanding articles 11 (2) and 12 (3), an assignor who assigns a receivable other than a trade receivable is not liable to the debtor for breach of a limitation on assignment described in articles 11 (1) and 12 (2), and the breach shall have no effect.

Variant B

Articles 11 and 12 and section II of chapter IV 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.]

References

A/CN.9/466, paras. 60-77

Commentary

50. Article 5, which appears within square brackets since it has not been adopted by the Working Group, is intended to address special needs of practices involving, for example, swaps and derivatives, repos, receivables in clearing-house transactions, deposit accounts, securities accounts, as well as insurance receivables and receivables arising from independent undertakings. In those practices, it is essential to ensure that the position of the debtor is not changed as a result of an assignment, without the debtor's consent (i.e. that the debtor may ignore any notification, discharge its debt as stipulated in the original contract, retain all its defences and rights of set-off, as well as the right to amend the original contract without the consent of the assignee).

51. With regard to swaps and derivatives in particular, the approach of article 5 appears to be justified by the fact that, in such financial transactions, it is inherent that any party may be debtor or creditor and, by definition, payments net against each other. As a result, if one payment is pulled out, the whole transaction may be unravelled. In other words, an assignment may increase the credit risk on the basis of which a party entered into the transaction. In view of the importance of such transactions for international financial markets and their volume, such a situation may create a systemic risk that may affect the financial system as a whole. The same two-way flow of payments and the need to preserve the mutual character of payments may exist with regard to clearing-house transactions. As to repos, it would need to be ensured that a party does not find its obligation to pay assigned to and pursued by another party while the original counter-party refuses to return the security.

52. As to other types of receivables (assignments of balances in deposit accounts, insurance receivables and proceeds of independent undertakings), an article 5 approach may be required for different reasons. With regard to independent undertakings, for example, there is a need to avoid upsetting well established practices or contradicting the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, New York, 1995 ("the Guarantee and Standby Convention")). Articles 11 (1) and 12 (2) would contradict article 10 of the Guarantee and Standby Convention, under which the beneficiary may not assign any proceeds without the consent of the guarantor/issuer. As to deposit accounts and securities accounts, it is essential to ensure that rights of set-off of the depositary institution or the securities broker are not affected.

53. In both variants A and B, receivables are defined by reference to the well known notion of "trade receivable". This approach has the advantage that it avoids the need to define the term "financial receivable", a term that is not universally understood in the same way and whose meaning keeps changing with the creation of new practices. On the other hand, by referring to any receivable other than a trade receivable, article 5 may inadvertently result in excluding transactions that should not be excluded. The Commission may, therefore, wish to define the excluded practices in a more specific way. The main difference between variants A and B lies in the fact that, under variant A, the assignment may be valid as between the assignor and the assignee and only its effects as against the debtor are left to law applicable outside the draft Convention, while, under variant B, the validity and effectiveness of an assignment altogether is left to law applicable outside the draft Convention. Another difference is that, unlike variant B, variant A gives the debtor the right to consent to the application of the draft Convention to the debtor's rights and obligations. Yet another difference between variants A and B is that, under variant A, the debtor would not have the right to terminate the original contract for breach of a contractual limitation on assignment.

54. The value of preserving the validity of the assignment as between the assignor and the assignee lies in the fact that such validity is a condition for obtaining priority. If the debtor pays the assignor, the assignee has a property claim in the assigned receivable. Such an approach is intended to facilitate practices in which the assignor receives payments on behalf of the assignee and holds the proceeds separate from its other assets

(e.g, securitization or undisclosed invoice discounting). In addition, such an approach is intended to preserve for assignors, assignees, third-party creditors and consenting debtors, in practices involving the assignment of financial receivables, or of both trade and financial receivables, the main benefits of the draft Convention, which cannot be ensured by way of contract as they are normally part of mandatory law (e.g. the validity of assignments of future receivables and of bulk assignments, as well as the priority rules of the draft Convention).

CHAPTER II. GENERAL PROVISIONS

Article 6. Definitions and rules of interpretation

For the purposes of this Convention:

(a) "Original contract" means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) "Existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "future receivable" means a receivable that arises after the conclusion of the contract of assignment;

[(c) "Receivables financing" means any transaction in which value, credit or related services are provided for value in the form of receivables. Receivables financing includes factoring, forfaiting, securitization, project financing and refinancing;]

(d) "Writing" means any form of information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(e) "N otification of the assignment" means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(f) "Insolvency administrator" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(g) "Insolvency proceeding" means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the assignor are subject to control or supervision by a court or other competent authority for the purpose of reorganization or liquidation;

(h) "Priority" means the right of a party in preference to another party;

(i) A person is located in the State in which it has its place of business. If the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised. If the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract. If a person does not have a place of business, reference is to be made to the habitual residence of that person;

(j) "Law" means the law in force in a State other than its rules of private international law;

(k) "Proceeds" means whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods;

[(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 financial services.]

References

A/CN.9/420, paras. 52-60
A/CN.9/432, paras. 70-72, 94-105
A/CN.9/434, paras. 78-85, 109-114, 167 and 244
A/CN.9/445, paras. 180-190
A/CN.9/456, paras. 53-78
A/CN.9/466, paras. 25-31, 46-49 and 94-100

Commentary

"Original contract"

55. The original contract, which is used as a point of reference in articles 5 (i) (iii), 17, 18 (1), 19 (1), 20 (1), 22 (2) (b) and 23, is the source of the assigned receivable. With the exception of those provisions which expressly state otherwise (e.g. articles 9-12 and 17-23), the draft Convention is not intended to affect the original contract.

"Existing" and "future" receivable

56. The terms "existing" and "future" receivable are referred to in articles 9 (effectiveness of an assignment) and 10 (time of assignment). The distinction between an existing and a future receivable is based on the time of the conclusion of the original contract. A receivable arising under a contract, which has been concluded before or at the time of assignment, is considered to be an existing receivable, even though it does not become due until a future date or is dependent upon counter-performance or some other stated event. The definition covers the entire range of future receivables, including conditional receivables (i.e. receivables that might arise subject to a future event that may or may not take place) and purely hypothetical receivables (i.e. receivables that might arise from an activity not initiated by the assignor at the time of the assignment; for a limitation introduced in article 9, see para. 89). The exact meaning of the term "conclusion of the contract" is left to law applicable outside the draft Convention. In any case, "conclusion" is not intended to refer to the performance of the contract.

"Receivables financing"

57. The term appears within square brackets in the preamble and in article 13 (3). The Commission may wish to delete this definition and, possibly, to refer to receivables financing only in the preamble (see para. 5).

"Writing"

58. The term is referred to in articles 6 (e), 19 (1) and (5), 21 (1) and (3), 41 (2) and (4), 44 (1) of the draft Convention and in article 5 of the annex. Its definition is intended to include other than paper-based means of communications that can perform the same functions as a paper communication (e.g. provide tangible evidence, serve as a warning to the parties with regard to the consequences or provide a legible communication, authentication and sufficient assurances as to its integrity). It is inspired by articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce and reflects the two distinct notions of "writing" and "signature".

59. On the assumption that the need for higher assurances as to the authenticity of communications should be assessed differently depending on the context in which the communication is made, the draft Convention requires a writing for the notification of the assignment and a writing signed by the debtor for the waiver of the debtor's defences. Writing is also required for declarations by States and for certain registration-related acts. "Accessible" is meant to imply that the communication is readable and interpretable; "usable" refers not only to use by a physical person but also by a computer; and "subsequent reference" establishes a standard that is akin to that implied by a notion such as durability (while not referring to the strict interpretation given to the notion of durability in certain legal systems as equivalent to non-alterability) but more objective than that implied by notions such as readability or intelligibility (see Guide to Enactment of the Model Law, para. 50). Signature is defined by reference to the identification of the signer and indication of the signer's approval of the content of the communication.

"Notification of the assignment"

60. The term is used in articles 15, 16, 18, 19, 20 (2) and 22. A notification meets the requirements of the draft Convention if it is in writing and reasonably identifies the assigned receivables and the assignee. If a notification does not meet those requirements, it is not effective under the draft Convention (i.e. it does not trigger a change in the way in which the debtor may discharge its obligation or does not affect the debtor's rights of set-off or the debtor's right to modify the original contract in agreement with the assignor). However, the question whether such a notification is valid under law applicable outside the draft Convention is subject to that law. In particular, if pursuant to such a non-conforming notification the debtor pays the person entitled to payment (whether under the draft Convention or other applicable law), under article 19 (6), the debtor is discharged (see para. 142).

61. What is a reasonable description in each particular case is a matter to be determined in view of the circumstances. In general, it would not be necessary to state whether an outright assignment or an assignment by way of security is involved or to specifically identify the debtor or the amount. A general identification along the lines "all my receivables from my car business to X" or "all my receivables as against my clients in countries A, B and C to Y" would be reasonable. However, in the case of a partial assignment, the amount assigned may need to be specified in the notification (on partial assignments, see paras. 32-34 and 91). Furthermore, while the notification must reasonably identify the assignee for it to be an effective notification under the draft Convention, it does not need to identify the payee (i.e. the person to whom or for whose account or the address to which the debtor is to pay). As a result, a notification containing no payment instruction is effective under the draft Convention (article 19 (2)). However, in view of the fact that, under the draft Convention, a notification changes the way in which the debtor may discharge its debt, parties notifying the debtor would be encouraged to include in their notification such a payment instruction. The Working Group based the discharge of the debtor on the notification rather than on the payment instruction in order to avoid confusing the debtor in cases where the two communications might be sent separately or in which several communications might be sent to the debtor by several persons.

"Insolvency administrator" and "insolvency proceeding"

62. The term "insolvency administrator" is used in articles 24 (a) (iii) and 30 (1) (a) (iii) of the draft Convention and articles 2 and 7 of the annex. The term "insolvency proceeding" is used in article 25 of the draft Convention and articles 2 and 7 of the Annex. Their definitions have been inspired by the definitions of "foreign proceeding" and "foreign administrator" contained in article 2 (a) and (d) of the UNCITRAL Model Law on Cross-Border Insolvency. They are also consistent with articles 1 (1) and 2 (a) and (b) of the European Union draft Regulation on Insolvency Proceedings. By referring to the purpose of a proceeding or to the function of a person, rather than using technical expressions that may have different meanings in different legal

systems, the definitions are sufficiently broad to encompass a wide range of insolvency proceedings, including interim proceedings. This approach is intended to avoid a Contracting State recognizing as an insolvency proceeding or administrator a proceeding or person who does not have that character under the *lex loci concursus* or is unable to recognize as an insolvency proceeding or administrator a proceeding or person who has that character under the *lex loci concursus*.

"Priority"

63. The term "priority" is used in articles 16, 24, 25 (2), 26, 27, 30 and 40 of the draft Convention, as well as in articles 1, 2, 6 and 7 of the annex. Priority under the draft Convention means that a party may satisfy its claim in preference to other claimants. Priority does not mean validity (in the draft Convention, the term "effectiveness" is used instead, to denote the proprietary effects of the assignment). It presupposes a valid assignment (substantive or material validity is dealt with in chapter III, while formal validity is left to law applicable outside the draft Convention; for a Secretariat suggestion to deal with the law applicable to formal validity, see paras. 80-82).

64. In addition, priority does not mean that a claimant has a proprietary (*in rem*) rather than a personal right (*ad personam*) with respect to the assigned receivable or any proceeds. This matter is left to the law of the assignor's location (articles 24 and 26). Moreover, priority does not prejudge the issue of whether the assignee with priority will retain all the proceeds of payment or turn over any remaining balance to the assignor or to the next claimant in the order of priority. This matter depends on whether an outright assignment or an assignment by way of security is involved, a matter left to law applicable outside the draft Convention (article 24). Priority does not affect the discharge of the debtor either. The debtor paying in accordance with article 19 (or, if article 19 is not applicable, in accordance with the law applicable under article 29) is discharged, even if payment is made to an assignee who does not have priority (under article 24 or, if article 24 is not applicable, under article 30). Whether that assignee will retain the proceeds of payment is a matter of priority to be resolved among the various claimants in accordance with the law applicable under article 24 (or article 30).

65. The definition does not refer to the right to payment since, while this expression might be appropriate for assignments by way of security, it might be restrictive in outright assignments in which the assignee may, for example, have a right to receive any goods returned by the debtor to the assignor. After the Working Group's decision to exclude returned goods from the definition of proceeds for the purposes of the priority rules of the draft Convention, the Commission may wish to revise the definition of priority to refer to a right to payment. The Commission may also wish to consider whether the combined application of articles 6 (h), 9 and 24 (a) (i) is sufficient to ensure that more than one assignment of the same receivables by the same assignor may be effective. This result is assumed in article 24 (a) (i), which refers to a conflict of priority between several assignees of the same receivables assigned by the same assignor. However, in some legal systems, this matter does not raise a question of priority at all but one of effectiveness (*nemo dat quod non habet*). As a result, in such jurisdictions, the first assignment may be considered effective under article 9 and any subsequent assignment ineffective under national law, for lack of title (a matter not addressed in article 9, dealing with the proprietary effects of assignment, although addressed in article 14, dealing with the contract of assignment). In such cases, article 24 may never come into play.

"Location"

66. This term is referred to in several provisions of the draft Convention (i.e. articles 1 (1) (a) and (2), 3, 4 (2), 17 (2), 21 (1), 23, 24, 25, 30, 35 (3), 36, 37 and 39). The two main subjects, however, in which the term "location" is referred to, are the scope of application and questions of priority. The definition is intended to strike a balance between flexibility and certainty. The place of business is a well known term, widely used in UNCITRAL and other international legislative texts, and on which abundant case law exists. It is used to denote a place in which the professional activities of a person or an entity are conducted. For the purpose of

the application of the law of a State, several places of business in one and the same State are considered one place of business. In order to ensure a sufficient degree of predictability of the application of the draft Convention with regard to the debtor, in the case of multiple places of business of the debtor, reference is made to the place with the closest connection to the original contract. On the other hand, with a view to ensuring that priority issues are referred to a single jurisdiction (and one in which any main insolvency proceeding is most likely to be opened), article 6 (i) provides that, if the assignor (or the assignee) has more than one place of business, "place of business" means the place of central administration. The rule contained in article 6 (i) is applied throughout the draft Convention in order to avoid defining "place of business" differently for different purposes. Such an approach could complicate the application of the draft Convention or even lead to inconsistent results.

67. Place of central administration is akin to the centre of main interests (a term used in the UNCITRAL Model Law on Cross-Border Insolvency), chief executive office or principal place of business. All those terms are understood as denoting the centre of management and control, the real business centre, from which in fact, not as a matter of form, the important activities of an entity are controlled and ultimate decisions at the highest level are actually made (without regard to the place where most assets are located or books and records are kept), rather than the day-to-day management of the affairs and operations of such an entity. However, unlike the UNCITRAL Model Law, in which a rebuttable presumption is established that the centre of main interests is the place of registration (article 16 (3)), the draft Convention does not introduce such a "safe harbour" rule. The reason for this approach is that, unlike the UNCITRAL Model Law whose main focus is on insolvency, the draft Convention focuses mainly on the advance planning in the financing of a solvent debtor and for that planning to be facilitated it is absolutely necessary to define location by reference to a single and easily determinable jurisdiction.

68. In most cases, the place of central administration would be easy to determine. However, the place of central administration may not be as transparent as the place of incorporation (formal location), for example, where the place of exercise of central authority is so evenly divided between two or more countries as to make the choice of one over the other impossible or in the case of subsidiary companies where the real administrative control resides in the parent company. However, the place of incorporation presents the disadvantage that it is not a notion known in many legal systems and that its use would raise the problem of the application of the law of a jurisdiction without a close connection to the contract of assignment, which may not have any developed laws. Referring to place of central administration and creating a rebuttable presumption in favour of the place of incorporation could provide a solution to this problem, but it would inadvertently result in reducing the level of certainty achieved by a place-of-central-administration location rule (since there may be more than one place of registration). In any case, in the exceptional situations in which the place of central administration did not readily point to a single jurisdiction, parties would be left in no worse situation than they were to begin with and would endeavour to ensure that their interest was effective and enforceable in each jurisdiction in which the assignor might possibly be located.

69. The definition of "location" does not address the problem of subjecting transactions of branch offices to the law of the head office (in particular priority issues, which may arise in cases where the same receivables are assigned by one or more branch offices and the head office, or by different branch offices to different assignees). In order to address that problem, the Working Group, at its thirty-first session, considered an exception for branch offices in the banking industry only or in other industries as well, but was not able to reach consensus (see A/CN.9/466, paras. 25-30, 96 and 97). At the end of the thirty-first session, a suggestion was made with respect to branch offices of financial service providers, which the Working Group, for lack of sufficient time, was not able to consider (see A/CN.9/466, paras. 98 and 99). The justification for such a limited exception is that financing institutions tend to do business abroad through branch offices so that they are able to draw on their capital as a whole (and not only the capital deposited, e.g. for the business of a separate entity, a subsidiary) and their branch offices tend to be subject to the law of the State in which they do business.

70. Under the proposed text, in the case of a branch of a financial service provider with more than one place of business, "place of business" of the assignor and the assignee means the place where the branch on whose books a receivable is carried immediately prior to the assignment is located. "Financial service provider" is defined by reference to a "bank or other financial institution" (e.g. a securities dealer) and "deposits, loans or other financial services". The exact meaning of those terms is left to law outside the draft Convention. "Branch" is defined by reference to a place of business other than the place of central administration. The words "is carried on the books" are defined by reference to "[accounting] [regulatory] standards", the exact meaning of which is also left to law outside the draft Convention. If an exception is introduced to the location rule with respect to branch offices of financial institutions, it would need to be made also with respect to other industries in which a branch-based structure is used (e.g. the insurance industry). The broader the exception is, the more the appropriateness of the central administration rule is put into doubt. In its deliberations on the issue of "location" of branch offices, the Commission may wish to take into account article 1 (3) of the UNCITRAL Model Law on International Credit Transfers ("for the purpose of determining the sphere of application of this law, branches and separate offices of a bank in different States are separate banks"). The Commission may wish to consider the placement of article 6 (i) in the text of the draft Convention (see para. 13).

"Law"

71. The term "law" appears in the preamble and in articles 1 (2), 5, variant B, 8 (2), 12 (1), (4) and (5), 21, 23 to 25, 28 to 32, 35 and 40 (2). The definition of "law" is intended to ensure that *renvoi* is avoided. If "law" included private international law provisions, any matter could be referred to a law other than the law applicable by virtue of the private international law provisions of the draft Convention. Such a result would defeat the certainty of applicable law sought by the private international law provisions of the draft Convention. The Commission may wish to define "law" for the case of a federal State with more than one legal system (for the application of the draft Convention in the case of a federal State, 202). Language along the following lines may be considered: "In the case of a State with two or more territorial units in which different systems of law are applicable in relation to matters dealt with in this Convention, 'law' means the law of the territorial unit identified in the rules in force in such a State identifying which territorial unit's law is applicable. In the absence of such rules, 'law' means the law of the territorial unit with the relevant connection". The Commission may also wish to consider whether any other federal-state interpretation clause would be necessary (e.g. with respect to the meaning of "location").

"Proceeds"

72. The term "proceeds" appears in articles 12 (1), 16 (1), 24 (b) and 26. Its definition is intended to cover both proceeds of receivables and proceeds of proceeds (e.g. if the receivable is paid by way of a cheque, the cheque is "proceeds of the receivable" and cash received by the payee of the cheque is "proceeds of proceeds"). It is also intended to cover, proceeds in cash ("payment") and proceeds in kind ("other satisfaction"), whether received in total or partial satisfaction of the assigned receivable. In particular, it is intended to cover goods received in total or partial discharge of the assigned receivable but not returned goods (e.g., because they were defective and the sales contract was cancelled or because the sales contract allowed the buyer to return the goods after a trial period). However, as between the assignor and the assignee, the assignee has a right in returned goods (see para. 126).

"Trade receivable"

73. The definition of "trade receivable", a term that appears in article 5, is in line with the general understanding with regard to this term as codified in the Ottawa Convention. Unlike the Ottawa Convention, however, subparagraph (l) excludes receivables arising from financial services.

Article 7. Party autonomy

The assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement.

References

A/CN.9/432, paras. 33-38
A/CN.9/434, paras. 35-41
A/CN.9/445, paras. 191-194
A/CN.9/456, paras. 79 and 80

Commentary

74. Article 7, which is modelled on article 6 of the United Nations Convention on Contracts for the International Sale of Goods, Vienna, 1980 ("the United Nations Sales Convention"), provides broad recognition of the principle of party autonomy. The assignor, the assignee and the debtor may vary or derogate from the provisions of the draft Convention. Unlike article 6 of the United Nations Sales Convention, however, article 7 does not allow parties to vary, or derogate from, provisions that affect the legal position of third parties, or to exclude the draft Convention as a whole. Accordingly, the assignor and the assignee may only vary or derogate from articles 13 to 16 and 28, while the assignor and the debtor are free to vary or derogate from articles 17 to 23, as long as the rights of third parties are not prejudiced. The reason for this different approach is that, while the United Nations Sales Convention deals with the mutual rights and obligations of the seller and the buyer, the draft Convention deals mainly with the proprietary effects of assignment and may, therefore, have an impact on the legal position of the debtor and other third parties. Allowing parties to an agreement to affect the rights and obligations of third parties would not only go beyond any acceptable notion of party autonomy but would also introduce an undesirable degree of uncertainty and could thus frustrate the main objectives of the draft Convention, that is, to facilitate increased access to lower-cost credit and to provide, at the same time, an adequate debtor protection system.

75. Like article 6 of the United Nations Sales Convention, article 7 requires an agreement, that is two corresponding declarations of intent, for the effective derogation from the draft Convention. Such an agreement may be explicit or implicit. A typical example of an implicit derogation is where the parties refer to the law of a non-Contracting State or to the domestic law of a Contracting State. Article 6 is intended to apply to an agreement between the assignor and the assignee ("third parties" are the debtor, the creditors of the assignor and the insolvency administrator) and to an agreement between the assignor and the debtor ("third parties" are the assignee, the assignor's creditors and the insolvency administrator). The Commission may wish to clarify whether article 6 should apply also to an agreement between the assignee and the debtor (e.g. an agreement whereby the debtor would waive its defences as against the assignee in return for a concession, such as a reduction of the interest rate or extension of the date of payment. Such agreements are not covered and, therefore, not limited by article 21 (see para. 150).

Article 8. Principles of interpretation

(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

References

A/CN.9/432, paras. 76-81
A/CN.9/434, paras. 100 and 101
A/CN.9/445, paras. 199 and 200
A/CN.9/456, paras. 82-85

Commentary

76. Article 8, inspired by article 7 of the United Nations Sales Convention, deals with the interpretation of and the filling of gaps in the draft Convention. With regard to the interpretation of the draft Convention, article 7 (1) refers to three principles, namely, the international character of the text, uniformity and good faith in international trade. These principles are common to most UNCITRAL texts. The reference to the international character or source of the text should lead a court to avoiding interpretation of the draft Convention on the basis of notions of national law, unless the meaning of a term used in the draft Convention is clearly identical with its meaning under a particular national law or is clearly left to law applicable outside the draft Convention. The need to preserve uniformity can be served only if courts or arbitral tribunals apply the draft Convention on its merits and have regard to decisions of courts or tribunals in other countries. The Case Law on UNCITRAL Texts (CLOUT), a system of reporting case law on UNCITRAL texts, has been established by UNCITRAL exactly with the need to preserve uniformity in mind. CLOUT is available in paper form in the six official languages of the United Nations and through the UNCITRAL home page on the World Wide Web (http:\\www.uncitral.org) in English, French and Spanish (depending on the resources available, the other language versions will also be made available in the future).

77. The reference to good faith relates only to the interpretation of the draft Convention. If as a result of a *contra legem* interpretation it is applied to the conduct of the parties, caution should be exercised. While the principle of good faith would appropriately be applied to the contractual relationship between the assignor and the assignee, or the assignor and the debtor, it could undermine the certainty of the draft Convention if applied to the relationship between the assignee and the debtor or the assignee and any other claimant. For example, if the principle of good faith prevailing in the forum State were to apply to the assignee-debtor or the assignee-third party relationship, the debtor, who might have paid the assignee after notification, may have to pay again if, for example, the debtor knew about a previous assignment; and the law applicable under article 24 might be disregarded if it does not respect the principle of good faith as it may be understood in the forum State.

78. As to gap-filling, the rule is that, if matters fall within the scope of the draft Convention under chapter I but are not expressly settled in it, they are to be decided in accordance with the general principles on which the draft Convention is based. Such principles include notably the principles expressly mentioned in the preamble or enshrined in a number of provisions of the draft Convention (e.g. the principle of facilitation of increased access to lower-cost credit and the principle of debtor protection). Recourse to private international law rules is permitted only if, with respect to a matter governed by, but not explicitly settled in, the draft Convention, there is no principle on the basis of which it could be resolved or the matter is not governed by the draft Convention at all. Gaps left in the private international law provisions of the draft Convention are to be filled in accordance with the private international law principles underlying the draft Convention. In the absence of such principles, such gaps would be filled in accordance with the private international law rules of the forum.

79. Matters not governed by the draft Convention and left to law applicable outside the draft Convention by virtue of private international law rules include, but are not limited to, the requirements and the legal consequences of an outright assignment, an outright assignment for security purposes and an assignment by way of security; the question of the form of the contract of assignment; the accessory or independent character

of a security right, which is the basis for determining whether it is transferred automatically with the receivables the payment of which it secures, or whether a new act of transfer is needed; and the consequences of a breach of representations by the assignor. The draft Convention covers statutory assignability to the extent that it specifies a number of receivables that are assignable, including future receivables and receivables not identified individually, but leaves other statutory limitations (relating, e.g. to pensions or wages) to other law. Matters left to law applicable outside the draft Convention also include: the question whether the assignor is liable towards the debtor for assigning trade receivables in violation of an anti-assignment clause; the debtor's obligation to pay (the draft Convention deals with the debtor's discharge only); the discharge of the debtor on grounds other than those specified in the draft Convention (e.g. by paying the rightful claimant if the notification received does not meet the requirements of the draft Convention); the defences and rights of set-off that the debtor may raise against the assignee; and agreements between the debtor and the assignee by which the debtor waives its defences and rights of set-off towards the assignee. Beyond those matters, the draft Convention explicitly refers certain matters (e.g. questions of priority) to law applicable outside the draft Convention, while specifying that law. Whether the law applicable to all the matters mentioned above, as well as to other matters not governed by the draft Convention, is to be determined on the basis of the private international law provisions of the draft Convention or of the forum, depends on whether the forum is in a Contracting State and on whether that Contracting State has opted out of chapter V.

CHAPTER III. EFFECTS OF ASSIGNMENT

Form of assignment

References

A/CN.9/420, paras. 75-79
A/CN.9/432, paras. 82-86
A/CN.9/434, paras. 102-106
A/CN.9/445, paras. 204-210
A/CN.9/456, paras. 86-92
A/CN.9/466, paras. paras. 101-103

Commentary

80. Chapter III settles issues of material validity of an assignment under the draft Convention. However, not all matters relating to material validity are settled in the draft Convention. Matters that are not addressed and are left to law outside the draft Convention include, for example, statutory limitations on assignment, other than those dealt with in articles 9, 11 and 12, and issues relating to capacity and authority. Matters of formal validity (e.g. whether writing, notification, registration or payment of a stamp duty is required for an assignment to be valid/effective) are not dealt with at all in the draft Convention. The Working Group considered a wide variety of form requirements, ranging from written form (with or without any signature requirements) to the absence of any form. The widely prevailing view was that written form should be required for the assignment to be effective, at least as against third parties. However, in order to avoid invalidating oral practices in some countries, the Working Group decided to avoid introducing a written form requirement. The Working Group also considered the question of the law applicable to form, but was not able to reach consensus. The difficulty in dealing with form lies in the fact that form is designed to perform various functions. As between parties, a form requirement may function as a warning to the assignor with regard to the seriousness of the undertaking or as evidence minimizing the risk of disputes. As against third parties, in particular third-party creditors, a form requirement is designed to operate as a protection against the risk of fraudulent collusion in oral assignments (e.g. collusive ante-dating of an assignment or collusion as to the scope of the receivables intended to be assigned).

81. However, failing to address the issue of form in the draft Convention will create uncertainty. The absence of any rule on form may be interpreted by users of the draft Convention in different ways. It may

either result in referring issues of form to law applicable outside the draft Convention or in validating any assignment irrespective of form. In the former case, uncertainty will arise with regard to the formal validity of an assignment under the draft Convention, which is a requirement of priority (as to the meaning of "priority", see paras. 63-65; this is reinforced by the fact that, unlike article 24 (b), article 24 (a) does not deal with "existence" of a right; see paras. 165 and 170). In the latter case, the assignor, in return for a concession granted by an assignee, in particular before commencement of insolvency, may be able to grant priority to that assignee by ante-dating or enlarging the scope of the assignment. The Commission may, therefore, wish to reconsider the issue of form. A substantive law rule would be preferable. However, it would seem that it would not be feasible to achieve consensus on such a rule. Therefore, a private international law approach may be considered.

82. The Commission may wish to consider the following alternatives: either introduce a flexible rule in line with current practice in private international law with regard to formal validity of the contract between the assignor and the assignee (the proper law of the contract, the law of the country where the contract is concluded or, in the case of contracts between persons in different countries, the law of one of those countries; see article 9 of the Rome Convention or article 13 of the Mexico City Convention), combining this rule with a different rule with regard to effects as against third parties (the law of the assignor's location); or establish a "safe harbour" rule along the following lines: "An assignment is effective as against third parties if it meets, *at least*, the form requirements of the law of the State in which the assignor is located" (for a special rule in the case of a receivable supported by a security right, see para. 108). A rule referring form as against third parties to the law of the assignor's location would not necessarily run counter to current practice in private international law, since such practice relates to the contract of assignment, not to the proprietary transfer itself, and form requirements for an assignment to be in writing, notified to the debtor or registered, are intended to provide a temporal link for competing claims and thus touch upon issues of priority. In any case, a "safe harbour" rule would allow third parties to determine the formal effectiveness of an assignment as a basis for priority and would be in line with the approach followed in article 24, without interfering with prevailing trends in private international law.

Article 9. Effectiveness of bulk assignments, assignments of future receivables and partial assignments

(1) An assignment of existing or future, one or more, receivables and parts of, or undivided interests in, receivables is effective, whether the receivables are described:

(a) Individually as receivables to which the assignment relates; or

(b) In any other manner, provided that they can, at the time of the assignment, or, in the case of future receivables, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective at the time of the conclusion of the original contract without a new act of transfer being required to assign each receivable.

References

A/CN.9/420, paras. 45-60
A/CN.9/432, paras. 93-112 and 254-258
A/CN.9/434, paras. 122 and 124-127
A/CN.9/445, paras. 211-214
A/CN.9/456, paras. 93-97

Commentary

83. Assignments of future receivables, bulk assignments and assignments of parts of or undivided interests in receivables are at the heart of significant financing practices (e.g. factoring, securitization, project financing, loan syndication and participation, swaps and derivatives). Yet their effectiveness as a matter of property law is not recognized in all legal systems. Article 9 is intended to validate such transfers of property rights in receivables.

Statutory assignability

84. In validating the assignments to which reference is made in paragraph (1), article 9 may set aside statutory prohibitions that might exist in national law with respect to such assignments. While setting aside such statutory limitations, the draft Convention is not intended to interfere with national policies. Such policies are aimed at protecting the assignor from alienating its future property and potentially depriving itself of means of subsistence. They are often articulated by means of a requirement for specificity, which may not be possible in the case of an assignment of future receivables or a bulk assignment. With a view to counterbalancing the need to validate the assignments mentioned in paragraph (1) and the need to protect assignors, article 9 (1) requires that the receivables be identifiable when they arise (i.e. when the original contract is concluded) as receivables to which the assignment relates. Furthermore, in order to avoid limiting the assignor's right to transfer future receivables, the draft Convention does not give priority to one creditor over another (e.g. to a global assignee over a small supplier of materials on credit with a retention of title extending to the receivables from the sale of the assignor's final products), but leaves matters of priority to national law. As to statutory limitations aimed at protecting the debtor in assignments mentioned in paragraph (1) (as, e.g., in the case of limitations relating to partial assignments), the draft Convention does not interfere with national policies underlying such limitations to the extent that the debtor needs to be located in a Contracting State and, under the draft Convention, does not have to incur any additional cost as a result of the assignment (see paras. 32-34 and 128).

85. The draft Convention is not intended to affect any other statutory limitations, whether aimed at protecting the assignor (e.g. wage claimants or owners of retirement annuities) or at protecting debtors (e.g. sovereign or consumer debtors). This matter is left to national law applicable outside the draft Convention. This result is implicit in article 11, which deals only with contractual limitations on assignment (with regard to sovereign debtors, see paras. 213 and 214; for consumer debtors, see para. 100). As a result of the fact that this result is not stated explicitly in the draft Convention, it would be a matter for interpretation whether such matters are governed by the draft Convention but not explicitly settled, in which case article 7 (2) would apply (i.e. reference would be made first to the general principles underlying the draft Convention and then to private international law rules), or not governed at all (i.e. they would be subject to the law applicable by virtue
of the private international law rules of the forum). In any case, uncertainty would arise that could have a negative impact on the availability and the cost of credit. The Commission may, therefore, wish to consider whether statutory assignability should be expressly addressed in the draft Convention. This result could be achieved by a new provision on statutory limitations along the following lines: "This Convention does not affect any statutory limitations on assignment other than those referred to in article 9." Alternatively, this result could be achieved by the exclusion of certain receivables in article 4 ("personal receivables, such as wages, pensions, receivables under transactions for personal, family or household purposes and sovereign receivables, to the extent they are not assignable under the law governing those receivables").

Effectiveness

86. The term "effective" is intended to reflect the proprietary effects of an assignment (the term "valid" could not have that effect and, in any case, is not universally understood in the same way). The exact meaning of such effectiveness, that is, whether the assignee may retain any surplus and the conditions under which the assignee may seek to enforce the receivable as against the debtor or have recourse against the assignor, depends

on whether an outright assignment or an assignment by way of security is involved, which is a matter left to law applicable outside the draft Convention. In any case, the assignee may claim and (if the debtor does not raise the absence of notification as a defence and pays) retain payment (the debtor may obtain a valid discharge under article 9, irrespective of whether it paid the person with priority). If the debtor pays someone else, the receivable is extinguished and the *in rem* or *ad personam* nature of the assignee's right and the priority of this right with respect to proceeds is to be determined in accordance with the law of the assignor's location (article 24 (b); see paras. 165 and 170).

87. While the assignee acquires a proprietary right in the assigned receivable, the effect of such a right is limited to the relationship between the assignor and the assignee and as against the debtor. Effectiveness as against third parties touches upon issues of priority and the draft Convention treats such issues as distinct issues, subjecting them to the law of the assignor's location (article 24). As a result, article 9 should set aside a statutory limitation on the assignment of future receivables or of receivables not identified specifically, for example, but not a rule dealing with priority between competing claims (or with statutory form requirements). Furthermore, in view of this interplay between effectiveness under article 9 and priority under article 24, article 9 would not validate the first assignment in time while invalidating any further assignment of the same receivables by the same assignor or result in the assignee prevailing over an insolvency administrator on the sole ground that the assignment took place before the effective date of the insolvency proceeding, even if the receivables arose or were earned after commencement of the insolvency proceeding. In order to reflect this interplay between effectiveness as between the assignor and the assignee and as against the debtor (as a condition for priority) and effectiveness as against third parties other than the debtor (priority) and to avoid inadvertently leaving the effectiveness of the assignments referred to in paragraph (1) altogether to the law applicable to priority, the Working Group decided to delete language in article 9 that would have made article 9, as well as article 10, subject to articles 24 to 27. For the same reason, the Working Group decided to include in article 24 wording ("with the exception of ...") clarifying that certain matters, including the effectiveness of an assignment as a matter of general law, are not left to the law governing priority (see para. 163).

88. However, the distinction between effectiveness and priority, which the draft Convention draws, may not be known in the law of the assignor's location, which may express limitations on assignment by way of a rule dealing with effectiveness in general. As a result, it may not be easy to determine, for example, whether a rule of the law of the assignor's location, limiting the effectiveness of an assignment of future receivables, is a rule dealing with effectiveness *inter partes* or with effectiveness as against third parties (i.e. priority). The Commission may, therefore, wish to state explicitly in the chapeau of article 9 (1) that an assignment is effective " as between the assignor and the assignee and as against the debtor". The Commission may also wish to state in a new paragraph (3) that: "The effectiveness of an assignment of the receivables referred to in paragraphs (1) and (2) of this article as against third parties other than the debtor is governed by the law applicable under article 24. However, such an assignment is not ineffective as against such third parties on the sole ground that the law of the assignor's location does not recognize its effectiveness." Such a rule would ensure that an assignment of future receivables would not be invalidated on the sole ground that it relates to future receivables, without, however, interfering with the effectiveness of such an assignment as a matter of priority between competing claimants.

"Existing or future receivables"

89. The terms are defined in article 6 (b) by reference to the time of the conclusion of the original contract. All future receivables are intended to be covered, including conditional receivables and purely hypothetical receivables (see para. 56). With a view to protecting the interests of the assignor, paragraph (1) introduces an element of specificity (receivables have to be identifiable at the time they arise).

"One or more"

90. The focus of the draft Convention is on the bulk assignment of a large volume of low-value receivables (e.g. factoring of trade receivables or securitization of credit card receivables) in view of their importance and practice and the fact that their effectiveness is not common ground to all legal systems. For reasons of consistency, the assignment of single, large-value receivables (e.g. the assignment of a loan for refinancing or portfolio diversification purposes) is also covered.

"Parts of or undivided interests in receivables"

91. Partial assignments are involved in significant transactions, such as securitization (in which the special purpose vehicle (SPV) may assign to investors undivided interests in the receivables purchased from their originator as security for the SPV's obligations to investors) or loan syndication and participation (in which the leading lender may assign undivided interests in the loan to a number of other lenders; for partial assignments, see paras. 32-34 and 61).

"Described"

92. The term "described" is intended to establish a standard lower than that which would be established by the term "specified". Under this standard, a generic description of the receivable, without any specification of the identity of the debtor or the amount of the receivable, would be sufficient (e.g. "all my receivables from my car business").

"Individually"/"in any other manner"

93. These words are intended to ensure that an assignment of existing and future receivables is effective, whether the receivables are described one by one or in any other manner that is sufficient to relate the receivables to the assignment.

Time of identification of receivables

94. Existing receivables are to be identified as receivables relating to the assignment at the time of the assignment. Future receivables should be identifiable at the time they arise (which is, by definition, after the time of the assignment). As a result of article 7, which enshrines party autonomy, the assignor and the assignee may agree on the time when future receivables should be identifiable to the assignment, as long as they do not affect the rights of the debtor and other third parties.

Master agreements

95. With a view to expediting the lending process and reducing the cost of the transaction, paragraph (2), in effect, provides that a master agreement is sufficient to transfer rights in a pool of future receivables. If a new document were to be required each time a new receivable arose, the costs of administering a lending programme would increase considerably and the time needed to obtain properly executed documents and to review those documents would slow down the lending process to the detriment of the assignor. Under paragraph (2), which provides that the master agreement is sufficient to transfer a pool of future receivables, and article 10, which provides that a future receivable is deemed to be transferred at the time of the conclusion of the contract of assignment, rights in future receivables are transferred directly to the assignee without passing through the estate of the assignor. As a result, the assignee would have a proprietary right and, if the assignee also has priority, its right would not be subject to the personal claims of the assignor's creditors or the insolvency administrator. In its original formulation, paragraph (2) referred to the time a future receivable "arises" with a view to clarifying that an assignment of a future receivable could be effective only if that receivable arises. In view of the deletion of the provision explaining the meaning of the word "arises", the Working Group, at its thirty-first session, decided to substitute the words "at the time of the conclusion of the original contract" for the word "arises". As a result, paragraph (2) deals with the time of assignment in a way

that is inconsistent with article 10, under which the assignment of future receivables is effective at the time of the conclusion of the contract of assignment and parties may agree only on a later time. The Commission may, therefore, wish to delete the reference to the time of the conclusion of the original contract of assignment and leave the matter to the commentary on article 10 (see para. 96). Alternatively, paragraph (2) could be aligned with article 10 and refer to the time of the conclusion of the contract of assignment.

Article 10. Time of assignment

An existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time.

References

A/CN.9/420, paras. 51 and 57
A/CN.9/432, paras. 109-112 and 254-258
A/CN.9/434, paras. 107, 108 and 115-121
A/CN.9/445, paras. 221-226
A/CN.9/456, paras. 76-78 and 98-103

Commentary

96. Article 10 is intended to recognize and, at the same time, limit the right of the assignor and the assignee to agree on the time at which a receivable is transferred; to set a default rule that, in the absence of contrary agreement between the assignor and the assignee, the time at which a receivable is transferred is the time of the conclusion of the contract of assignment; and to clarify the meaning of other relevant provisions, such as articles 7, 9, 19 and 24 to 27. The time of assignment agreed between the assignor and the assignee binds third parties, a matter that may not be sufficiently clear in article 7. However, for such an agreement to be binding on third parties, it has to set a time of transfer that is not earlier than the time of the conclusion of the contract of assignment. This approach is in line with the principle of party autonomy enshrined in article 7, since an agreement setting an earlier time of assignment could affect the order of priority between several claimants (however, neither article 7 nor article 10 precludes the parties from agreeing to ante-date the coming into force of their mutual contractual obligations).

97. In the absence of an agreement between the assignor and the assignee setting the time of transfer of rights in the assigned receivables, the time of such transfer is the time of the conclusion of the contract of assignment, which is a fact that cannot be changed. While this approach is obvious with regard to receivables existing at the time they are assigned, a legal fiction is created with regard to future receivables (i.e. receivables arising from contracts not in existence at the time of the assignment). In practice, the assignee would acquire rights in future receivables only if they were in fact created, but, in legal terms, the time of transfer would go back to the time of the conclusion of the contract of assignment. Giving the assignee a proprietary right in the assigned receivable as of the time of the conclusion of the contract of assignment would result in protecting an assignee with priority under the law of the assignor's location. Without such a proprietary right, even the right of an assignee with priority may be subject to the rights of secured and preferential creditors in the case of insolvency.

Article 11. Contractual limitations on assignments

(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the assignor's right to assign its receivables.

(2) Nothing in this article affects any obligation or liability of the assignor for breach of such an agreement. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

References

A/CN.9/420, paras. 61-68
A/CN.9/432, paras. 113-126
A/CN.9/434, paras. 128-137
A/CN.9/445, paras. 49-51 and 227-231
A/CN.9/447, paras. 148-152
A/CN.9/455, paras. 47-51
A/CN.9/456, paras. 104-116
A/CN.9/466, paras. 104-106

Commentary

98. The main objective of article 11, which is inspired by article 6 of the Ottawa Convention, is to establish a balance between the need to protect the debtor, on the one hand, and the need to protect the assignor and the assignee, on the other. The debtor may have good commercial reasons for limiting the ability of the assignor to assign the receivable (e.g. concern of incurring additional expenses). On the other hand, the assignor may need to assign its receivables to obtain financing or a service, and the assignee may have no way of knowing about the existence of a contractual limitation on assignment (as, e.g., in the case of future receivables or bulk assignments).

Substantive and territorial scope

99. Article 11 is intended to apply to contractual limitations, whether contained in the original contract or other agreement between the assignor and the debtor or in the initial or any subsequent assignment contract. It is also intended to apply to any contractual clauses limiting the assignment (e.g. by making it subject to the debtor's consent) and not only to clauses prohibiting assignment. It is not designed to apply, however, to statutory limitations to assignment or to limitations relating to the assignment of rights other than receivables (e.g. confidentiality clauses). As a result, if an assignment is made in violation of a statutory limitation or a confidentiality clause, article 11 does not apply to validate such an assignment or limit any liability existing under law outside the draft Convention. Depending on the approach the Commission decides to take with regard to assignments of financial receivables, the scope of the rule in article 11 may be different and the effectiveness of an assignment in general or only as against the debtor may be left to law applicable outside the draft Convention (see article 5 and paras. 50-54).

100. Article 5 is also intended to apply to assignments of receivables owed by sovereign debtors, unless a State in which that debtor is located makes a reservation under article 38 as to the application of article 11 (see paras. 2135 and 2146). In such a case too, whether an assignment is effective as against a sovereign debtor would be left to law outside the draft Convention. Furthermore, article 11 is intended to apply to assignments of receivables owed by consumer debtors. It is not intended, however, to override consumer-protection legislation (although, in practice, with the exception of wealthy individuals, who may not need statutory protection, consumers do not have the bargaining power to include such limitations in their contracts; for consumer receivables and consumer protection, see paras. 36, 128, 152, 160 and 196). In any case, consumers would either not even be notified of any assignment or would be notified and asked to continue paying to the same bank account or post office box. In such a case, a debtor concerned about losing rights of set-off that may arise from contracts unrelated to the original contract could discontinue its relationship with the assignee.

101. In effect, with the limited application of article 11 to consumer situations and with the exclusion of financial service providers (article 5) and the possible exclusion of Governments and public entities (article 38), article 11 would apply mainly to cases where the debtor is a large supplier who may not be in need of statutory protection. In any case, the Commission may wish to consider further limiting the scope of the rule in

article 11 to assignments of future receivables or receivables assigned in bulk, in which validating contractual limitations would have a negative impact on the cost of credit. In other assignments (e.g. of single, existing receivables), a contractual limitation would render the assignment ineffective as against the debtor (draft article 12.301 of the European Contract Principles). Such an approach would preserve the free transferability of receivables in important financing transactions, while limiting any undue interference with party autonomy. The Commission may also wish to deal with assignments that are not true assignments but rather take-over bids (i.e. where a competitor obtains an assignment of the debts of an entity in order to obtain access to confidential business information, although if such information is covered by a confidentiality clause and an assignment provides to the assignee access to confidential information, article 11 would not apply to validate such an assignment).

The rule

102. The thrust of the rule in article 11 is that both the contractual limitation on assignment and the assignment are effective. However, unlike the assignment, which is effective as against the debtor, the contractual limitation does not produce any effects as against the assignee. The underlying policy is that it is more beneficial for everyone to facilitate the assignment of receivables and to reduce the transaction cost rather than to ensure that the debtor would not have to pay a person other than the original creditor (assignor). Under article 11 (1), the debtor is bound by the assignment. The question whether there is any liability for breach of contract is left to law applicable outside the draft Convention. If there is any such liability, under article 11 (2), it is not extended to the assignee and cannot be based solely on the assignee's knowledge of the contractual limitation (knowledge may be relevant in the case of tortious liability of the assignee, e.g. for malicious interference with advantageous contractual relations). Penalizing the assignee for having mere knowledge of the anti-assignment clause would inadvertently result in encouraging the assignee either to avoid a due-diligence test or to proceed with such a test and refuse to accept the receivables or accept them at a much lower price. Other rights that the debtor may have under law outside the draft Convention such as, for example, the right to terminate the original contract for breach of contract, are not affected either, unless a financial receivable is involved (see, article 5, variant A, paragraph (2); for a Secretariat suggestion to limit the rights of the debtor to a claim for compensatory damages, see para. 104).

Justification

103. Contractual limitations have a negative impact on the value of receivables, whether they relate to all receivables assigned in bulk or only to some. If contractual limitations were enforceable as against assignees, assignees would have to examine the documentation of each receivable. As a result, a small number of receivables that are subject to contractual limitations would raise the cost on a much larger number of receivables that are not subject to any such restriction. In addition, unless they are aimed at preserving legitimate interests, contractual limitations may constitute an undue interference with market economy principles. To the extent that the payment obligation has the same effect on the debtor, irrespective of the identity of the creditor, a contractual restriction would run counter to the principle against restraints of alienation of property. Furthermore, an economy in which receivables are freely transferable yields substantial benefits to debtors. The cost savings achieved for creditors through the free transferability of their receivables can be passed along to debtors in the form of lower costs for goods and services or lower cost for credit.

104. In any case, the draft Convention provides a high level of protection to the debtor (articles 17-22). In addition, under law applicable outside the draft Convention, the debtor may even declare the original contract avoided (with the exception of debtors of financial receivables; article 5, variant A, para. (2)). Such avoidance of the contract, however, which could deprive the assignee of the contractual right to demand payment from the debtor, should be available only in exceptional circumstances (the assignor may have an unjust enrichment claim or other claims arising by operation of law against the debtor but any assignment of such rights would not

be covered by the draft Convention). Otherwise, the risk of the contract being avoided might in itself have a negative impact on the cost of credit. In order to avoid this result, the Commission may wish to consider clarifying in article 11 that any relief available to the debtor against the assignor for breach of an anti-assignment clause would be limited to a claim for compensatory damages (or that the debtor may not declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause; see article 5, variant A, paragraph (2)). Articles 11, 20 (3) and 22 could be construed as precluding such a radical remedy anyway, at least after notification of the assignment. Allowing the debtor to declare the contract avoided on the sole ground of the violation of an anti-assignment clause would run counter to the principle that the assignment is effective even if it is made in violation of an anti-assignment clause and to the principle that, in such a case, the debtor may not raise against the assignee any claim it might have against the assignor for breach of contract. In addition, if the minimum, that is, a modification of the original contract, is not allowed after notification of the debtor without the consent of the assignee, the maximum, that is the cancellation of the contract, could not be allowed either. Such a limitation of the debtor's cancellation rights may be combined with the approach taken in article 5, variant B, paragraph (2). If the assignment is ineffective as against the debtor, the debtor would not need to cancel the original contract simply because of a violation of a contractual limitation on assignment (see para. 102).

Article 12. Transfer of security rights

(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless, under the law governing the right, it is transferable only with a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

(2) A right securing payment of the assigned receivable is transferred under paragraph (1) of this article notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2) of this article. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

(4) The transfer of a possessory property right under paragraph (1) of this article does not affect any obligations of the assignor to the debtor or the person granting the property right with respect to the property transferred existing under the law governing that property right.

(5) Paragraph (1) of this article does not affect any requirement under rules of law other than this Convention relating to the form or registration of the transfer of any rights securing payment of the assigned receivable.

References

A/CN.9/420, paras. 69-74
A/CN.9/432, paras. 127-130
A/CN.9/434, paras. 138-147
A/CN.9/445, paras. 232-235
A/CN.9/456, paras. 117-126

Commentary

Accessory and independent rights

105. Paragraph (1) reflects the generally accepted principle that accessory security rights (e.g. a suretyship, pledge or mortgage) are transferred automatically, while independent security rights (e.g., an independent guarantee or a standby letter of credit or a real security right of an abstract nature) are transferable only with a new act of transfer (the words "right securing payment" are used in order to ensure that rights that may not be security rights, for example, rights arising from independent guarantees and standby letters of credit, would be covered). Under article 7, the assignor and the assignee may agree that an accessory right is not transferred to the assignee and is thus extinguished. Such an agreement may reflect the lack of willingness on the part of the assignee to accept the responsibility and the cost involved in the maintenance and safekeeping of collateral (e.g. taxation and insurance costs in the case of real estate or storage and insurance costs in the case of equipment). The question of the accessory or independent character of the right and the substantive or procedural requirements to be met for the creation of such a right are left to the law governing that right. In view of the wide range of rights covered by article 12 and the divergences existing among the various legal systems in this regard, article 12 does not attempt to specify the law applicable to such rights. Paragraph (1) also creates an obligation for the assignor to transfer to the assignee any independent right securing payment of the assigned receivables as well as the proceeds of such a right. As a result, if an independent right and its proceeds are assignable, the assignee will be able to obtain them. If such rights are not assignable or not assigned for any reason, the assignee will have a personal claim against the assignor. As to the formulation of paragraph (1), the Commission may wish to consider deleting the second part of the first sentence (i.e. the words "unless ... transfer") as superfluous (the first part of the second sentence may be sufficient).

Contractual limitations

106. Paragraph (2) is intended to ensure that any limitation agreed upon between the assignor and the debtor or other person granting a security right does not invalidate the assignment. Under paragraph (3), any liability that the assignor may have for breach of contract, under law applicable outside the draft Convention, is not affected but is not extended to the assignee (this approach is consistent with the approach taken in article 11). The underlying policy is that, with regard to limitations on assignment, security rights should be treated in the same way as receivables, since often the value relied upon by the assignee lies in the security right and not in the receivable itself. However, a limitation included in a contract with a sovereign third-party guarantor located in a State that has made a declaration under article 38 would render the assignment ineffective but only as against the sovereign third-party guarantor. Similarly, a limitation in a contract with a third-party guarantor of a financial receivable may invalidate the assignment in general or only as against the third-party guarantor, depending on whether the Commission adopts variant A or variant B of article 5.

Possessory rights

107. Whether or not the transfer of a security right is prohibited by agreement, if it involves the transfer of possession of the collateral and such transfer causes damage to the debtor or the person granting the right, any liability that may exist under law applicable outside the draft Convention is not affected. Paragraph (4) envisages, for example, a transfer of pledged shares that might empower a foreign assignee to exercise the rights of a shareholder to the detriment of the debtor or any other person who might have pledged the shares.

Form requirements

108. Under paragraph (5), any requirements of the law applicable outside the draft Convention relating to the form of the transfer of security rights are not affected. As a result, a notarized document and registration may be necessary for the effective transfer of a mortgage, while delivery of possession or registration may be required for the transfer of a pledge. In addition, the draft Convention is not intended to affect any requirements as to the form of an assignment of receivables secured by a certain asset (e.g. registration of an assignment secured by real estate or by aircraft). However, if the Commission includes a rule on the form of assignment, subjecting the form of the assignment to the law of the assignor's location (see paras. 80-82), that

rule would need to be aligned with paragraph (5) (e.g, by providing that the law of the assignor's location would govern form, unless the receivables are backed by a security right, in which case the law governing that right would govern form).

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Commentary

Purpose of section I

109. Unlike the other provisions of the draft Convention that deal with the proprietary aspects of assignment, the provisions contained in this section deal with contractual issues. The usefulness of these provisions lies in the fact that they recognize party autonomy, a principle enshrined in a general way in article 7, and provide default rules applicable in the absence of an agreement between the assignor and the assignee. Such default provisions offer important benefits. They reduce transaction costs by allocating risks and by eliminating the need for parties to replicate standard terms and conditions in their contract. They also reduce dispute resolution costs by providing a clear-cut rule for both the courts and the parties in the event the parties have not addressed a particular issue. Furthermore, they perform a useful educative function by offering a checklist of matters for parties to address at the time of the initial contract negotiations. Most significantly, they enhance uniformity and certainty by reducing the need for courts to look to national solutions offered by the proper law of the contract. However, the role of the proper law of the contract is not wholly eliminated in section I of chapter IV. The effect of mistake, fraud or illegality on the validity of the contract is left to the proper law of the contract, as are remedies available for breach of contract (in so far as they are not characterized as procedural and are, therefore, subject to the *lex fori*).

Article 13. Rights and obligations of the assignor and the assignee

(1) The rights and obligations of the assignor and the assignee as between them arising from their agreement are determined by the terms and conditions set forth in that agreement, including any rules or general conditions referred to therein.

(2) The assignor and the assignee are bound by any usage to which they have agreed and, unless otherwise agreed, by any practices which they have established between themselves.

(3) In an international assignment, the assignor and the assignee are considered, unless otherwise agreed, to have impliedly made applicable to the assignment a usage which in international trade is widely known to, and regularly observed by, parties to the particular [receivables financing] practice.

References

A/CN.9/432, paras. 131-144
A/CN.9/434, paras. 148-151
A/CN.9/447, paras. 17-24
A/CN.9/456, paras. 127 and 128

Commentary

110. The primary purpose of article 13 is to restate in the context of the relationship between the assignor and the assignee the principle of party autonomy, a principle already reflected in general terms in article 7. The assignor and the assignee are free to structure their mutual rights and obligations so as to meet their particular needs. They are also free to incorporate into their agreement any rules or conditions by referring to them in a

general manner, rather than reproducing them in their agreement. The conditions, under which the parties may exercise their freedom, and the relevant legal consequences are left to the law governing their agreement. In line with article 9 of the United Nations Sales Convention, article 13 also states in paragraphs (2) and (3) a principle that may not be recognized in all legal systems, namely, that, in the interpretation of assignment contracts, trade usages and practices must be taken into account. Paragraph (2) draws a clear distinction between trade usages and practices established between the assignor and the assignee. Such usages and practices may produce rights and obligations for the assignor and the assignee. However, they cannot bind third parties, such as the debtor or creditors of the assignor. They cannot bind subsequent assignors or assignees either. All those parties would not necessarily be aware of usages agreed upon by, and practices established between, the initial assignor and the initial assignee.

111. In view of the recognition of party autonomy in paragraph (1), parties will always have the right to agree otherwise as to the binding nature of practices established between themselves. The words “unless otherwise agreed” contained in paragraph (2) may therefore not be necessary. These words, which do not appear in article 9 (1) of the United Nations Sales Convention, had initially been included in paragraph (2), since, as opposed to the hierarchy of legal rules established in the United Nations Sales Convention, the draft Convention prevails over the parties’ agreement. After the limitation of paragraph (1) to the mutual rights and obligations of the assignor and the assignee, the rule about the prevalence of the draft Convention has been deleted and the reason for deviating from the wording of article 9 (1) of the United Nations Sales Convention has been eliminated.

112. Paragraph (3) defines the scope of the matters covered by an international usage. Under paragraph (3), international usages bind only the parties to international assignments. Such a limitation was not thought to be necessary in article 9 of the United Nations Sales Convention since this Convention applies only to international transactions. It is, however, necessary in article 13 in view of the fact that the draft Convention may apply to domestic assignments of international receivables. In addition, under paragraph (3), as under article 9 (2) of the United Nations Sales Convention, usages are applicable only to the relevant practice. This means that an international factoring usage cannot apply to an assignment in a securitization transaction. However, unlike article 9 (2) of the United Nations Sales Convention, paragraph (3) does not refer to the subjective, actual or constructive knowledge of the parties but only to the objective requirements that the usages must be widely known and regularly observed. The Working Group felt that, while such a reference to the subjective knowledge of the parties might be useful in a two-party relationship, it would be inappropriate in a tripartite relationship, since it would be extremely difficult for third parties to determine what the assignor and the assignee knew or ought to have known. In view of the fact that article 13 has been revised to make clear that it refers to the rights and obligations of the assignor and the assignee as between themselves and that, under article 7, agreements between parties do not affect third parties, the Commission may wish to reconsider this matter.

Article 14. Representations of the assignor

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion of the contract of assignment that:

(a) The assignor has the right to assign the receivable;

(b) The assignor has not previously assigned the receivable to another assignee; and

(c) The debtor does not and will not have any defences or rights of set-off.

(2) Unless otherwise agreed between the assignor and the assignee, the assignor does not represent that the debtor has, or will have, the financial ability to pay.

References

A/CN.9/420, paras. 80-88
A/CN.9/432, paras. 145-158
A/CN.9/434, paras. 152-161
A/CN.9/447, paras. 25-40
A/CN.9/456, paras. 129 and 130

Commentary

Party autonomy/default rules

113. Representations undertaken by the assignor are intended to reduce the risk of whether the assignee will be able to collect the receivables from the debtor, if necessary. Because of their purpose, representations constitute a significant factor in the assignee's determination of the amount of credit to be made available to the assignor and the cost of credit. In view of their importance, representations are highly negotiated and explicitly settled between the assignor and the assignee. Recognizing this reality, article 14 embodies the principle of party autonomy with regard to representations of the assignor. Such representations may stem from the financing contract, the contract of assignment (if it is a separate contract) or any other contract between the assignor and the assignee. In accordance with article 13 (2) and (3), they may also stem from trade usages and practices. Article 14 allows parties to modify the representations, whether explicitly or implicitly, even those which relate to the very existence of the assigned receivable.

114. In addition to recognizing the principle of party autonomy, article 14 is intended to set forth a default rule allocating risks between the assignor and the assignee in the absence of an agreement of the parties as to this matter. In the allocation of risks, the overall aim of article 14 is to counterbalance the need for fairness and the need to facilitate increased access to lower-cost credit. Article 14 is consistent with normal practice in which the assignor guarantees the existence of the assigned receivable but not the solvency of the debtor. If the parties have not agreed on representations, in the absence of a rule along the lines of article 14, the risk of non-payment would be higher. This situation could defeat a transaction (if the risk is too high) or, at least, reduce the amount of credit offered and raise the cost of credit. Furthermore, to the extent that the assignor has to bear a certain risk, the assignor's goods or services would be more expensive or even inaccessible to the debtor.

Representations as to the "existence" or assignability of a receivable

115. Under paragraph (1), the assignor represents that it has the right to assign the receivable, that it has not assigned it already and that the debtor does and will not have any defences. In view of the need for the assignee to be able to estimate the risk involved in a transaction before extending credit, paragraph (1) provides that the representations have to be made, and take effect, at the time of the conclusion of the contract of assignment. Such representations are considered as being given not only to the immediate assignee but also to any subsequent assignee. As a result, any subsequent assignee may turn against the assignor for breach of representations. If representations were considered as being undertaken only as against the immediate assignee, any subsequent assignee would have recourse only against its immediate assignor, a process that would increase the risk and thus the cost of transactions involving subsequent assignments. Subparagraphs (a) to (c) introduce representations that could be broadly described as representations relating to "the existence" of the receivable (or its assignability). If the assignor does not have the power to assign, has already assigned or has deprived the receivable of any value by improperly performing the contract with the debtor, the receivable does not "exist". The Commission may wish to consider whether other existence-related representations, such as the factual basis of the claim, its formal and substantive validity and enforceability are sufficiently covered (see draft article 12.204 of the European Contract Principles).

116. The assignor is in violation of the representation as to its right to assign, introduced in subparagraph (a), if it does not have the capacity or the authority to act, or if there is any statutory limitation on assignment. This approach is justified by the fact that the assignor is in a better position to know whether it has the right to assign. However, the assignor is not liable for breach of representations if the original contract contains a limitation on assignment. The Working Group decided that no explicit reference to that rule was necessary in subparagraph (a), since it is implicit in article 11, under which the assignment is effective even if it is in breach of an agreement limiting assignment. The representation, contained in subparagraph (b), that the assignor has not already assigned the receivable is aimed at holding the assignor accountable to the assignee if, as a result of a previous assignment by the assignor, the assignee does not have priority. This result may occur if the assignee has no objective way of determining whether a previous assignment has occurred. Subparagraph (b), however, does not require the assignor to represent that it will not assign the receivables to another assignee after the first assignment. Such a representation would run counter to modern financing practice in which the right of the assignor to offer to different lenders parts of the same receivables as security for obtaining credit is absolutely essential. The Commission may wish to consider whether subparagraph (b) should cover also assignments or other transfers by law (see draft article 12.204 (c) of the European Contract Principles).

117. Subparagraph (c) places on the assignor the risk of hidden defences or rights of set-off of the debtor that may defeat in whole or in part the assignee's claim. This provision is premised on the fact that, by performing its contract with the debtor properly, the assignor will be able to preclude such defences from arising. In particular in the context of the sale of goods in which service and maintenance elements are included, such an approach would result in a greater degree of accountability of the assignor for performing properly its contract with the debtor. The provision is also based on the assumption that, in any case, the assignor will be in a better position to know whether the contract will be properly performed, even if the assignor is just the seller of goods manufactured by a third person (there is no need for the assignor to have actual knowledge of any defences). Furthermore, subparagraph (c) is premised on the fact that placing on the assignor the risk of hidden defences normally has a beneficial impact on the cost of credit. Subparagraph (c) has a wide scope, encompassing defences and rights of set-off whether they have a contractual or non-contractual source and whether they relate to existing or to future receivables. It also covers rights of set-off, whether they arise from the original or any related contract or from contracts unrelated to the original contract (with the exception of rights of set-off from unrelated contracts that become available after notification, which under article 20 (2) the debtor cannot raise against the assignee). With regard to representations relating to the absence of defences against future receivables assigned in bulk by way of security, the Working Group thought that the representation contained in subparagraph (c) properly reflected current practice. According to such practice, in bulk assignments of defence-free and defence-ridden receivables assignors normally receive credit only in the amount of those receivables which are not likely to be subject to defences, while they have to repay a higher amount. In addition, in the case of non-payment by the debtor, the assignor has to take back the receivables for which the assignee is not able to obtain payment from the debtor and replace them with other receivables or to pay back the price of the unpaid receivables ("recourse financing").

Representations as to the solvency of the debtor

118. Paragraph (2) reflects the generally accepted principle that the assignor does not guarantee the solvency of the debtor. As a result, the risk of debtor default is on the assignee, a fact that the assignee takes into account in determining whether to extend credit and on what conditions. Recognizing the right of the parties to financing transactions to agree on a different risk-allocation, paragraph (2) allows the assignor and the assignee to agree otherwise. Paragraph (2) also provides that such an agreement may be implicit or explicit. The question of what constitutes an implicit agreement is left to the contract interpretation rules of the law governing the contract.

Additional representations

119. The Commission may wish to consider adding to the representations listed in paragraph (1) that the assignor will not modify the original contract without the actual or constructive consent of the assignee (article 22) and that the assignor will transfer to the assignee any non-accessory security or other supporting rights (article 12; see also article 12.204 (d) and (e) of the European Contract Principles).

Breach of representations

120. The Working Group decided to leave the legal consequences of a breach of representations to other law. Reasons cited by the Working Group in support of this approach include that matters relating to the underlying financing contract were beyond the scope of the draft Convention and, in any case, it would be very difficult to reach agreement on issues such as liability for breach of representations. The Commission may wish to consider addressing, at least, any consequences a breach of representations may have on the assignment (i.e. whether the receivables are automatically re-transferred to the assignor or whether a new act of transfer is necessary). This issue is of particular importance if the assignor becomes insolvent after a breach of representations.

Article 15. Right to notify the debtor

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. However, nothing in this article affects any obligation or liability of the party in breach of such an agreement for any damages arising as a result of the breach.

References

A/CN.9/420, paras. 89-94 and 119-122
A/CN.9/432, paras. 159-164 and 175
A/CN.9/434, paras. 162-165
A/CN.9/447, paras. 41-47
A/CN.9/456, paras. 131-144 and 193
A/CN.9/466, paras. 116 and 117

Commentary

Independent right of the assignee to notify the debtor and request payment

121. The main objective of article 15 is to recognize the right of the assignee to notify the debtor and to request payment, even without the cooperation or the authorization of the assignor. It is not intended to define notification (article 6) or to address the conditions for a notification to be effective as against the debtor (article 18) or the legal consequences of notification (articles 19, 20 and 22). Granting the assignee an autonomous right to notify the debtor is considered important, in particular since the assignor might be unwilling or, in the case of insolvency, unable to cooperate with the assignee. Furthermore, at least in those legal systems in which priority is determined on the basis of the time of notification of the debtor, the assignor, acting in collusion with one claimant against the interests of another claimant, could determine the order of priority, unless each claimant had the right to notify the debtor independently of the assignor. The Working Group recognized that, in some practices, it was normal for the assignor to send a bill to the debtor requesting payment and notifying the debtor about the assignment (e.g. in factoring). At the same time, however, the Working Group was mindful of the fact that, in other practices, it was important for the assignee to be able to

notify and to request payment independently of the assignor, whether in the event of default or not. The protection of the debtor against the risk of being notified and being asked to pay a potentially unknown person was thought to be a different matter, which could be addressed by allowing the debtor in the case of notification by the assignee to request adequate proof (by definition, a notification has to identify the assignee; see para. 60; see also draft article 12.303 of the European Contract Principles, under which, in such a case the assignment has to be in writing and the debtor has to have a chance to inspect it).

Notification as a right, not an obligation

122. With a view to accommodating non-notification practices, notification is formulated in paragraph (1) as a right and not as an obligation. In such practices, normally the debtor is not notified of the assignment and the assignor receives payment on behalf of the assignee. Article 15 is also intended to recognize practices in which the debtor keeps paying as before the assignment, while the assignor and the assignee agree on the control of the bank account or post office box to which payment is made. In those practices, in order to avoid any inconvenience to the debtor that might result in an interruption to the normal flow of payments, the debtor is either not notified at all or is notified and instructed to continue paying the assignor (such a notification is normally intended to preclude the debtor from acquiring rights of set-off after notification from contracts unrelated to the original contract). In those practices, the debtor is notified and given different payment instructions (i.e. to pay the assignee or another person or to a different account or address) only in exceptional situations (e.g. in the case of default).

Notification and payment instruction

123. In line with the approach followed in article 6 (e) (which defines notification without any reference to a payment instruction), paragraph (1) draws a clear distinction between a notification and a payment instruction. This approach is intended to recognize the difference, both in purpose and in time, between a notification and a payment instruction and to validate practices in which notification is given without any payment instructions. Under this approach, a mere notification of an assignment is valid for the purpose of cutting off the debtor's rights of set-off arising from contracts unrelated to the original contract, as well as for the purpose of changing the way in which the assignor and the debtor may amend the original contract. However, in order to avoid complicating the debtor's discharge, the Working Group decided not to base the debtor's discharge on the receipt of a payment instruction. Under paragraph (1), a payment instruction may be sent either by the assignor or the assignee with the notification or, subsequent to a notification, by the assignee. Paragraph (1), unlike article 19, refers to the time notification is "sent" (and not "received"), since neither the assignor nor the assignee has a way to assess the time of receipt. That matter may be important for the discharge of the debtor, dealt with in article 19, but not for the determination of who has the right to give a payment instruction as between the assignor and the assignee.

Agreements as to notification

124. While paragraph (1) grants the assignee an autonomous right to notify the debtor and to request payment, paragraph (2) recognizes the right of the assignor and the assignee to negotiate and agree on the matter of notification of the debtor so as to meet their particular needs. For example, the assignor and the assignee may agree that no notification would be given to the debtor as long as the flow of payments is not interrupted (as, e.g., in undisclosed invoice discounting). In order to ensure that there is no need for a specific agreement, the opening words of paragraph (1) are formulated in a negative way ("unless otherwise agreed"). The rule introduced in paragraph (2) is that, if notification is given in violation of such an agreement and the debtor pays, the debtor is discharged. The underlying rationale is that the debtor should be able to discharge its obligation as directed in the notification and should not concern itself with the private arrangements existing

between the assignor and the assignee. Whether the person violating such an agreement is liable for breach of contract under law applicable outside the draft Convention is a separate matter and should not affect the discharge of the debtor, who is not a party to that agreement. A notification given in violation of an agreement between the assignor and the assignee, however, does not cut off any rights of set-off of the debtor from contracts unrelated to the original contract (article 20), trigger a change in the way the assignor and the debtor may amend the original contract (article 22), or create a basis for the determination of priority under the law applicable to priority issues (articles 24-26). The Working Group thought that such results would give an undue advantage to the assignee who wrongfully notified the debtor. The negative formulation in paragraph (2) "is not ineffective" is intended to ensure that the mere violation of an agreement between the assignor and the assignee, on the one hand, does not invalidate the notification for the purpose of debtor-discharge, but, on the other hand, does not interfere with contract law as to the conditions required for such an agreement to be effective.

Article 16. Right to payment

(1) As between the assignor and the assignee, unless otherwise agreed, and whether or not a notification of the assignment has been sent:

(a) If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

(b) If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to the assignor in respect of the assigned receivable; and

(c) If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to such person in respect of the assigned receivable.

(2) The assignee may not retain more than the value of its right in the receivable.

References

A/CN.9/447, paras. 48-68 A/CN.9/466, paras. 118-123
A/CN.9/456, paras. 145-159

Commentary

Objective and scope

125. Article 16 is intended to state explicitly what is already implicit in articles 2 and 9, namely, that, as between the assignor and the assignee, the assignee has a proprietary right in the assigned receivable and any proceeds (as against third parties, this matter is left to the law governing priority under article 24 (b)). As the scope of article 16 is limited to the relationship between the assignor and the assignee, it is subject to the general principle of party autonomy embodied in article 7 and is intended to operate as a default rule applicable in the absence of an agreement between the assignor and the assignee. It is not intended to affect the debtor's legal position or issues of priority.

Rights in proceeds and returned goods

126. As between the assignor and the assignee, the assignee's right extends to proceeds (which, under article 6 (k), includes both proceeds of receivables and proceeds of proceeds), as well as to returned goods. In this context, the Working Group considered that there was no reason to limit the ability of the assignor and the assignee to agree that the assignee could claim any returned goods and that, even in the absence of an agreement, a default rule allowing the assignee to claim any returned goods could reduce the risks of non-collection from the debtor and thus have a positive impact on the cost of credit. Paragraph (1) covers situations in which payment has been made to the assignee, the assignor or another person. In the latter case, the assignee's right is, under paragraph (1) (c), subject to priority. Paragraph (2) reflects normal practice in assignments by way of security, under which the assignee may have the right to collect the full amount of the receivable owed, plus interest owed on the ground of contract or law, but has to account for and return to the assignor or its creditors any balance remaining after payment of the assignee's claim. Paragraph (2) does not repeat the reference to a contrary agreement of the parties, which is included in the chapeau of paragraph (1), since the assignee's right in the assigned receivable flows from the assignment contract and is, under article 13, subject to party autonomy anyway. As to the interplay between articles 16 and 38, it should be noted that a sovereign debtor, located in a State that has made a reservation under article 38, could discharge its debt by paying the assignor, while the assignee would have a right to claim the proceeds of payment from the assignor.

Notification of the debtor

127. The assignee's right in proceeds is independent of any notification of the assignment. The reason for this approach is the need to ensure that, if payment is made to the assignee before notification, the assignee may retain the proceeds of payment, and if payment is made to the assignor after notification (which does not discharge the debtor's debt), the assignee would have a right in such payment. Such a right is of particular importance if the assignor or the debtor becomes insolvent. If payment is made to the assignor after notification, in principle the assignee could claim payment from the assignor, under article 16 (1) (b), or from the debtor, under article 19 (2). This result is appropriate in that the debtor, who pays the assignor after notification, takes the risk of having to pay twice. In practice, however, the assignee would not claim a second payment from the debtor, unless the assignor has become insolvent. In such a case, any claim that the debtor might have against the estate of the insolvent assignor (e.g. on the basis of the principles of unjust enrichment) would normally be meaningless, since it is unlikely that claimants with personal claims would be able to obtain payment.

Section II. Debtor

Article 17. Principle of debtor protection

(1) Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

(2) A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

(a) Change the currency of payment specified in the original contract, or

(b) Change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

References

A/CN.9/420, para. 101
A/CN.9/432, paras. 33-38, 89, 90, 206 and 244
A/CN.9/434, paras. 86-95
A/CN.9/445, paras. 195-198
A/CN.9/456, paras. 21, 81 and 168-176

Commentary

Principle of debtor protection

128. The principle of debtor protection is one of the main general principles of the draft Convention. It is referred to in a general manner in the preamble and in article 17. Furthermore, it is reflected in a number of provisions of the draft Convention (e.g. articles 1 (3), 5, 7, 19-23, 28 and 38). The thrust of the rule set forth in paragraph (1) is that there are no implied effects of the draft Convention on the legal position of the debtor (any doubt as to whether an assignment changes the debtor's legal position should be resolved in favour of the debtor). The draft Convention is, in particular, not designed to change, without the consent of the debtor, the payment terms stipulated in the original contract (e.g. the amount owed, whether for principal or interest; the date of payment; and any conditions precedent to the debtor's obligation to pay), the defences or rights of set-off that the debtor may raise under the original contract, or to increase expenses in connection with payment. A principle flowing from article 17 is that the draft Convention is not intended to have an adverse effect on the rights of consumer debtors and, in particular, to override consumer-protection legislation (articles 21 (1) and 23; for consumer receivables and consumer protection, see paras. 36, 100, 152, 160 and 196).
Country and currency risk

129. Whatever change is effected in the debtor's legal position as a result of an assignment under the draft Convention, under paragraph (2), a payment instruction, whether given with the notification or subsequently, may not change the currency of payment. It may not change the country of payment either, unless the change is beneficial to the debtor and results in payment being allowed in the country in which the debtor is located. Such a change of the country of payment is often allowed in factoring contracts with a view to facilitating payment by debtors. The Commission may wish to make even that change subject to the debtor's consent so as to cover those exceptional cases in which the debtor may have an interest in paying in the country identified in the original contract and not in its own country.

Article 18. Notification of the debtor

(1) A notification of the assignment and a payment instruction are effective when received by the debtor, if they are in a language that is reasonably expected to inform the debtor about their contents. It shall be sufficient if a notification of the assignment or a payment instruction is in the language of the original contract.

(2) A notification of the assignment or a payment instruction may relate to receivables arising after notification.

(3) Notification of a subsequent assignment constitutes notification of any prior assignment.

References

A/CN.9/420, paras. 124 and125
A/CN.9/432, paras. 176,177 and 187
A/CN.9/434, paras. 172-175
A/CN.9/447, paras. 45-47, 158 and 159
A/CN.9/455, paras. 59-66
A/CN.9/456, paras. 177-180

Commentary

Time of effectiveness of notification: the receipt rule

130. The primary purpose of article 18 is to restate the "receipt rule" with regard to the time of effectiveness of a notification, that is, that a notification and a payment instruction become effective when received by the debtor. A notification, whether accompanied by a payment instruction or not, has significant consequences for the legal position of the debtor (it triggers a change in the way in which the debtor may discharge its debt, it cuts off rights of set-off arising from contracts unrelated to the original contract and it changes the way in which the debtor may amend the original contract in agreement with the assignor). Such consequences may occur only when a notification or a payment instruction is in a language that is "reasonably expected to inform the debtor about its contents". For example, when the notification is in electronic form and is not readily readable, the debtor should be able to decode it easily. In order to avoid creating uncertainty, paragraph (1) introduces a "safe harbour" rule, according to which the language of the original contract meets the required standard.

Notification with respect to receivables not existing at the time of notification

131. Unlike article 8 (1) (c) of the Ottawa Convention, which provides that notification may be given only with respect to receivables existing at the time of notification (and which reflects current factoring practice), paragraph (2) allows a notification to be given with respect to receivables not existing at the time of notification. Such a notification may not have an impact on the debtor's discharge until the original contract is concluded and the payment obligation becomes due. However, it simplifies and reduces the cost of notification in that it ensures that the assignee does not need to give a notification each time a receivable arises. It also ensures that, once a receivable arises, the debtor cannot accumulate rights of set-off from unrelated contracts with the assignor or modify the original contract without the consent of the assignee. More importantly, such a notification allows the assignee to obtain priority, once the receivable arises, as of the time notification is received by the debtor, if, under the law of the assignor's location, priority is determined on the basis of the time of notification (in order to achieve this result, draft article 24 provides that matters settled in the draft Convention, including notification-related matters, are excluded from the law of the assignor's location; see para. 163). The time when a receivable arises is left to law applicable outside the draft Convention.

Notification in subsequent assignments

132. Paragraph (3), which is inspired by article 11 (2) of the Ottawa Convention, is one of the most important provisions of the draft Convention, in particular for international factoring transactions. In such transactions, the assignor normally assigns the receivables to an assignee in its own country (export factor) and the export factor subsequently assigns the receivables to an assignee in the debtor's country (import factor). Under such an arrangement, collection from the debtor is facilitated to the extent that the import factor is able to take all the necessary measures for the second assignment to be effective as against the debtor. The efficient operation of such transactions is based on the assumption that the first assignment is also effective as against the debtor. In view of the fact that the debtor is normally notified only of the second assignment, it is essential to ensure that notification of the second assignment covers the first assignment as well. Otherwise, the first assignment might be rendered ineffective as against the debtor, a situation that might affect the effectiveness of the second assignment as well. In order to address situations in which more than one subsequent assignment is made, paragraph (3) provides that a notification covers any prior, and not only the immediately preceding, assignment (with regard to the issue of the discharge of the debtor in the case of several notifications relating to subsequent assignments, see para. 138). The Commission may wish to consider whether a notification should indicate that it relates to a subsequent assignment, even if it does not list all the subsequent assignments. Such an approach would allow the debtor to determine, in the case of multiple notifications, whether it should pay in accordance with the first notification received (article 19 (2)) or in accordance with the notification of the last of such subsequent assignments (article 19 (4)).

Article 19. Debtor's discharge by payment

(1) Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract. After the debtor receives notification of the assignment, subject to paragraphs (2) to (6) of this article, the debtor is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor, in accordance with such instructions.

(2) If the debtor receives notification of more than one assignment of the same receivable made by the same assignor, the debtor is discharged by paying in accordance with the first notification received.

(3) If the debtor receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

(4) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.

(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, 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.

(6) This article does not affect any other ground on which payment by the debtor to the person entitled to payment, to a competent judicial or other authority, or to a public deposit fund discharges the debtor.

References

A/CN.9/420, paras. 98-117, 127-131, 169-173 and 179
A/CN.9/432, paras. 165-174 and 178-204
A/CN.9/434, paras. 176-191
A/CN.9/447, paras. 69-93 and 153-157
A/CN.9/455, paras. 52-58
A/CN.9/456, paras. 181-193
A/CN.9/466, paras. 124-132

Commentary

133. Article 19 has a twin goal, to provide a clear mechanism for the discharge of the debtor’s obligation by payment and to ensure payment of the debt. It is not intended to deal with the discharge of the debtor in general or with the payment obligation as such, since that obligation is subject to the original contract and to the law governing that contract. It is not intended to address issues of priority either. The basic rule is that, until the debtor receives notification of an assignment, it may be discharged by paying in accordance with the original contract, while, after notification, discharge is obtained only by payment in accordance with the instructions given by the assignor or by the assignee with the notification, or subsequently by the assignee. Article 19 deals also with a number of particular situations in which several notifications are involved, the debtor is notified by the assignee and is in doubt as to whether the assignee is the rightful claimant, and with discharge effected by payment under law applicable outside the draft Convention.

Debtor’s discharge by payment before and after notification

134. Under paragraph (1), until the time of receipt of a notification, the debtor is entitled to discharge by paying in accordance with the original contract (i.e. by paying the assignor or another person or to an account

or address indicated in the original contract). In view of the fact that the assignment is effective as of the time of the conclusion of the contract of assignment, the debtor, having knowledge of the assignment, may choose to discharge its debt by paying the assignee. However, in such a case the debtor takes the risk of having to pay twice, if it is later proved that no assignment took place. The Working Group decided not to refer explicitly to the possibility of the debtor being able to pay either the assignor or the assignee in order to avoid undermining practices, such as securitization, in which the debtor is normally expected to continue paying the assignor. The reference to payment "in accordance with the original contract", rather than to payment to the assignor, is intended to preserve the right of the assignor and the debtor to agree to any type of payment suitable to meet their needs (e.g. payment to a bank account without identification of the account owner, or payment to a third person).

135. After notification, the debtor does not have a choice as to how to discharge its debt. The debtor may only discharge its obligation by paying the assignee or as instructed by the assignee. The reference to payment instructions is intended to address the needs of various practices. The assignee may, for example, notify the debtor, so as to freeze the debtor's rights of set-off, without requesting payment or requesting the debtor to continue paying the assignor (this is the case, e.g., with undisclosed invoice discounting or securitization). To avoid leaving any uncertainty, paragraph (1) repeats what is already stated in article 15 (1), namely, that such instructions may be given by the assignor or the assignee with the notification or only by the assignee subsequent to a notification.

Knowledge/good faith

136. Knowledge of an assignment is not to be treated as a notification and to trigger a change in the way in which the debtor could discharge its obligation. While making business practice conform to good faith standards is an important goal, this should not be at the expense of certainty. Certainty would be reduced if knowledge of the assignment were to trigger a change in the way in which the debtor could discharge its obligation. Knowledge should not be treated as a notification, since, in certain cases in which the assignee does not have the business structure necessary to receive payments (e.g. in securitization), it is normal business practice for the debtor to continue paying the assignor even though the debtor knows of the assignment. With regard to whether the nullity (e.g. for fraud or duress or lack of capacity to act) or whether the knowledge of the nullity of an assignment should be taken into account in the debtor's discharge, the Working Group decided that the issue of payment to a person, the assignment to whom was null and void, arose only in exceptional situations and could be left to law applicable outside the draft Convention. The Commission may wish to reconsider this matter. Even if fraudulent notifications do not pose a problem in practice, the fact that a debtor could not rely on a *prima facie* legitimate notification may undermine the certainty necessary for the debtor to obtain a discharge. A rule that would protect a debtor paying in good faith in the case of a "purported assignment" would be consistent with the overall policy to protect the debtor (draft article 12.308 of the European Contract Principles refers to a debtor who performs in good faith and neither knows nor ought to know of such invalidity).

Debtor's discharge and priority/knowledge of superior claims

137. Unlike article 8 (1) of the Ottawa Convention, article 19 does not require the debtor to pay the person with priority so as to obtain a valid discharge. Having agreed that the assignment should not adversely affect the legal position of the debtor, the Working Group drew a clear distinction between the issue of the debtor's discharge and the issue of priority. Thus, payment under article 19 discharges the debtor, even if the person receiving payment does not have priority. It would be unfair and inconsistent with the policy of debtor protection to require the debtor to determine who among several claimants has priority and that the debtor pay a second time if, in the first instance, it has paid the wrong person. The debtor would most likely have a cause of action against that person, but the debtor's rights may be frustrated if that person becomes insolvent. The risk of insolvency of the person who received payment should be on the various claimants of the receivables and not

on the debtor. Such claimants would have to settle among themselves their rights in the proceeds of payment in accordance with the law governing priority under the draft Convention.

Multiple notifications

138. Paragraphs (2) and (4) are intended to provide simple and clear discharge rules in the case of several notifications. Paragraph (2) deals with situations in which the debtor receives several notifications relating to more than one assignment of the same receivables by the same assignor ("duplicate assignments"). Such situations do not necessarily involve fraud. They may, for example, involve several outright assignments for security purposes of receivables for credit not exceeding the value of the receivables. In such assignments, the main issue is who will obtain payment first (i.e. who has priority). Paragraph (4) deals with notifications relating to more than one subsequent assignment. Such situations are rare in practice, since normally only the last in a chain of assignees notifies the debtor and requests payment. In any case, in order to avoid any uncertainty as to how the debtor may discharge its debt, paragraph (4) provides that the debtor has to follow the instructions contained in the notification of the last assignment in a chain of assignments. For that rule to apply, the notifications received by the debtor have to be readily identifiable as notifications relating to subsequent assignments. Otherwise, the rule contained in paragraph (2) would apply and the debtor would be discharged by payment in accordance with the first notification received (for a Secretariat suggestion in this regard, see para. 132). In any case, under paragraph (5), the debtor, if in doubt, could request adequate proof from the assignees notifying. If the debtor receives several notifications relating to several assignments of the same receivables by the same assignor and to subsequent assignments, under a combined application of paragraphs (2) and (4), the debtor is discharged by paying in accordance with the first notification of the last assignment (as to the debtor's discharge in the case of partial subsequent assignments, see paras. 32-34).

Change or correction of payment instructions

139. Paragraph (3) is intended to ensure that the assignee may change or correct its payment instructions. Whether the debtor is notified by the assignor or the assignee, if a new payment instruction is sent with regard to one and the same assignment, the debtor may discharge its debt only in accordance with that instruction. The only condition is that, in line with the policy underlying article 15 (1), subsequent to the notification, a payment instruction be given by the assignee. In order to protect the debtor against the risk of having to pay twice, paragraph (3) expressly provides that a payment instruction received by the debtor after payment is to be disregarded.

Right of the debtor to request additional information

140. Under article 15, notification may be given not only by the assignor but also by the assignee independently of the assignor. As a result, the debtor may receive notification of the assignment from a possibly unknown person and may be in doubt as to whether that person is a legitimate claimant, payment to whom would discharge the debtor. In order to protect the debtor from uncertainty as to how to discharge its debt in such cases, paragraph (5) gives the debtor a right to request the assignee to provide adequate proof of the assignment within a reasonable period of time. Paragraph (5) does not introduce an obligation of the debtor, since requesting additional proof in all cases would unnecessarily delay payment and add to the cost of the notification. The determination of what constitutes "adequate" proof and a "reasonable" period of time is a matter of interpretation for the courts or arbitral tribunals taking into account the particular circumstances. The Working Group thought that the flexibility introduced with these terms was necessary, since no rule could be found that would be suitable for all possible cases. In addition, in order to avoid any uncertainty that might ensue as a result of the use of these terms, the Working Group decided to include a "safe harbour" rule, according to which a written confirmation from the assignor constituted adequate proof (in such a case, under draft article 12.303 of the European Contract Principles, the assignment has to be in writing and the debtor should have a chance to inspect it).

141. The notification does not trigger the obligation to pay, which remains subject to the original contract and the law applicable thereto. This means that the debtor does not have to pay upon notification and does not owe interest for late payment while it awaits the adequate proof requested. If, however, the debt becomes payable within that period in accordance with the original contract, the question arises as to whether the payment obligation is suspended until the debtor receives such proof and has a reasonable time to assess and act on it. If the payment obligation is not suspended, the significance of the protection afforded to the debtor by paragraph (5) may be reduced to the extent that the debtor delaying payment, even for good reasons, would have to pay interest. The Working Group proceeded on the understanding that the payment obligation would be suspended in such cases, but chose not to include any explicit wording in paragraph (5), since that result could be reached, in any event, without any additional wording and such wording could inadvertently interfere with national law on interest.

Debtor's discharge under other law

142. Paragraph (6) is intended to ensure that article 19 does not exclude other ways of discharge of the debtor's obligation that may exist under national law applicable outside the draft Convention (e.g. a notification not conforming with the requirements of article 6 (f), 15 or 18).

Article 20. Defences and rights of set-off of the debtor

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may raise against the assignee all defences or rights of set-off arising from the original contract, or any other contract that was part of the same transaction, of which the debtor could avail itself if such claim were made by the assignor.

(2) The debtor may raise against the assignee any other right of set-off, provided that it was available to the debtor at the time notification of the assignment was received.

(3) Notwithstanding paragraphs (1) and (2) of this article, defences and rights of set-off that the debtor may raise pursuant to article 11 against the assignor for breach of agreements limiting in any way the assignor's right to assign its receivables are not available to the debtor against the assignee.

References

A/CN.9/420, paras. 66-68 and 132-135
A/CN.9/432, paras. 205-209
A/CN.9/434, paras. 194-197
A/CN.9/447, paras. 94-102
A/CN.9/456, paras. 194-199
A/CN.9/466, paras. 133-136

Commentary

143. Article 20 is another particular application of the general principle that the debtor's legal position should not be unduly affected as a result of the assignment. The debtor has against the assignee all the defences and rights of set-off that the debtor could raise against the assignor (for an exception, see article 20 (3)). What those defences and rights of set-off are is a matter not addressed in the draft Convention but left to other law. However, the assignee is not a party to the original contract and incurs, therefore, no positive contractual liability for non-performance by the assignor. In such a case, the debtor can raise the non-

performance to defeat the assignee's claim, but needs to make a separate claim against the assignor to obtain, for example, compensation for any loss suffered as a result of the assignor's non-performance.

Defences and rights of set-off under the original and related contracts: no limitation

144. Under paragraph (1), the debtor may raise against the assignee all the defences that arise from the original contract, without any limitation, including contractual claims, which, in some legal systems, might not be considered "defences"; rights for contract avoidance, for example, for mistake, fraud or duress; exemption from liability for non-performance, for example, because of an unforeseen impediment beyond the control of the parties; and counter-claims under the original contract. The debtor may also raise defences and rights of set-off arising from contracts between the assignor and the debtor that are closely related to the original contract (e.g. a maintenance or other service agreement supporting the original sales contract) and should be treated in the same way as rights of set-off arising from the original contract. Such defences and rights of set-off may be raised irrespective of whether they are available at the time of notification of the assignment or become available only after such notification.

Other rights of set-off: available up to notification of the debtor

145. Paragraph (2) introduces a time limitation with regard to rights of set-off arising from any source other than the original contract, that is, a separate contract between the assignor and the debtor, a rule of law (e.g., a tort rule) or a judicial or other decision. Such rights may not be raised against the assignee if they become available after notification of the assignment. The rationale underlying this rule is that the rights of a diligent assignee who notifies the debtor should not be made subject to rights of set-off arising at any time from separate dealings between the assignor and the debtor or other events, of which the assignee could not reasonably be expected to be aware. On the other hand, the interests of the debtor are not unduly affected, since, if the fact that the debtor cannot accumulate rights of set-off constitutes an unacceptable hardship for the debtor, the debtor can avoid entering into new dealings with the assignor (on the question whether the debtor could declare the original contract avoided, see paras. 102 and 104). In view of the above-mentioned rationale of paragraph (2), rights of set-off arising from separate contracts between the debtor and the assignee are not affected. Such rights can be asserted against the assignee even after notification of the assignment, like rights of set-off arising from the original contract. It should also be noted that a notification results in freezing the debtor's rights of set-off, whether it contains a payment instruction or not. This approach is intended to accommodate practices in which a bare notification is given exactly for the purpose of precluding the debtor from accruing rights of set-off from acts or omissions of the assignor that are beyond the assignee's control, while the debtor is expected to continue paying the assignor.

"Available"

146. The exact meaning of the term "available" (e.g. whether the right of set-off has to be "actual and ascertained" at the time notification is received by the debtor) is left to other law. The Working Group was not able to agree on introducing such a clarification in the text of article 20, since it considered that it would result in limiting inappropriately the rights of set-off available to the debtor to those which are quantified at the time of the notification. The Working Group was not able to agree on the law governing issues relating to rights of set-off either (see, however, para. 195). The Commission may wish to consider clarifying, at least, that the relevant cross-claim of the debtor does not need to have matured at the time of notification. Otherwise, a debtor's potential cross-claim, due to mature at the same time as the creditor's claim, would be extinguished by the creditor's assignment of its claim. Such a result would run counter to the principle that an assignment should not prejudice the debtor's legal position.

Defences and rights of set-off in the case of breach of a contractual limitation

147. Paragraph (3) is intended to ensure that the debtor may not raise against the assignee by way of defence or set-off the breach of a contractual limitation by the assignor. The debtor may have a cause of action against the assignor, if, under law applicable outside the draft Convention, the assignment constitutes a breach of contract that results in a loss to the debtor. However, the mere existence of a contractual limitation is not a violation of the representation contained in article 14 (1) (a). In the absence of a provision along the lines of paragraph (3), article 11 (2), holding the assignee harmless for breach of contract by the assignor could be deprived of any meaning.

Article 21. Agreement not to raise defences or rights of set-off

(1) Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. Such an agreement precludes the debtor from raising against the assignee those defences and rights of set-off.

(2) The debtor may not exclude:

(a) Defences arising from fraudulent acts on the part of the assignee;

(b) Defences based on the debtor's incapacity.

(3) Such an agreement may be modified only by an agreement in a writing signed by the debtor. The effect of such a modification as against the assignee is determined by article 22 (2).

References

A/CN.9/420, paras. 136-144
A/CN.9/432, paras. 218-238
A/CN.9/434, paras. 205-212
A/CN.9/447, paras. 103-121
A/CN.9/456, paras. 200-204
A/CN.9/466, paras. 137-140

Commentary

Waivers of defences agreed between the assignor and the debtor

148. In order to obtain more value for their receivables and at a lower cost, assignors normally guarantee as against assignees the absence of defences and rights of set-off by the debtor. Recognizing this practice, article 14 (1) (c) provides that such a guarantee exists even in the absence of an agreement between the parties in this regard. In practice, if such representations cannot be given and the receivables are likely to be subject to defences, such receivables are either not accepted by assignees, or are accepted at a significantly reduced value or only on a recourse basis (i.e. if the assignee cannot collect from the debtors, it has the right to return the receivables to and collect from the assignor). In order to avoid those adverse effects, assignors, as a matter of practice, negotiate with debtors waivers of the defences and rights of set-off that debtors may raise against any future assignee. On the basis of such waivers, assignees determine the credit terms offered to assignors, which in turn are likely to affect the credit terms assignors offer to debtors.

149. With a view to allowing assignors to obtain lower-cost credit, article 21 validates such waivers of defences and rights of set-off. Furthermore, in order to avoid uncertainty as to the legal consequences of a waiver and that a court may override it as being unfair to the debtor or as being enforceable only as between the assignor and the debtor, paragraph (1) states what may appear obvious in some legal systems, namely, that a

waiver agreed upon between the assignor and the debtor may benefit the assignee. In recognition of the fact that in practice a waiver may be agreed upon at the time of the conclusion of the original contract, as well as at an earlier or later time, paragraph (1) does not make specific reference to the point of time at which a waiver may be agreed upon. Paragraph (1) does not require either that the defences are known to the debtor or are explicitly stated in the agreement by which the defences are waived. The Working Group thought that such a requirement would introduce an element of uncertainty, since the assignee would need to establish in each particular case what the debtor knew or ought to have known. Whether the acceptance of an assignment by the debtor should be construed as a waiver or as a confirmation of a waiver or whether a waiver of defences is to be construed as a consent or confirmation of the debtor's consent to the assignment is left to other law.

Waivers of defences agreed between the assignor and the debtor

150. Paragraph (1) is limited to waivers agreed upon by the assignor and the debtor. As a result, the limitations contained in paragraph (2) do not apply to waivers agreed upon by the debtor and the assignee. The Working Group thought that the draft Convention should not limit the debtor's ability to negotiate with the assignee in order to obtain a benefit, such as a lower interest rate or a longer payment period. At the same time, the Working Group also thought that, in view of the fact that agreements between assignees and debtors were outside the scope of the draft Convention, the draft Convention should not empower the debtor to negotiate waivers with assignees, if, under the law applicable, the debtor would not have such a power (see para. 75).

Limitations on waivers

151. While aimed at facilitating increased access to lower-cost credit, which is in the interest of trade in general, article 21 does not neglect the protection of the debtor. In order to protect debtors from undue pressure by creditors to waive their defences, paragraphs (1) and (2) introduce reasonable limitations with respect to such waivers of defences. Such limitations refer to the form in which such waivers can be made, to certain types of debtors and to certain types of defences.

152. Under paragraph (1), a waiver cannot be a unilateral act or an oral agreement; it has to take the form of a written agreement signed by the debtor, so as to ensure that both parties, and in particular the debtor who is waiving rights, are well informed about the fact of the waiver and its consequences, including the benefits offered to the debtor in return, and to facilitate evidence. In addition, a waiver cannot override the consumer-protection law prevailing in the country in which the debtor has its place of business (for consumer receivables and consumer protection, see paras. 36, 100, 128 and 196). In cases where the draft Convention applies, this provision in effect substitutes a specific applicable law reference to the debtor's location for the general rule set forth in article 29. In order to avoid terminological and other differences existing among the various legal systems, paragraph (1) refers to debtors in transactions for "personal, family or household purposes". Furthermore, under paragraph (2), a waiver cannot relate to defences arising from fraudulent acts committed by the assignee. Such a result would run counter to basic good faith standards. With a view to protecting an assignee who accepts an assignment in good faith, the Working Group decided not to apply the same limitation to defences relating to fraud by the assignor. If the debtor could not waive such defences, the assignee would have to investigate in order to ensure that no fraud was committed by the assignor in the context of the original contract. The limitation under paragraph (2), however, applies not only to defences relating to fraud by the assignee alone but also to defences relating to fraud by the assignee in collusion with the assignor.

Modifications of waivers

153. In line with paragraph (1), paragraph (3) requires the form of a written agreement signed by the debtor for the modification of a waiver. Parties need to be warned of the legal consequences of such a modification, which should be easily proved, if necessary. With a view to ensuring that a modification, which may be agreed upon by the assignor and the debtor, does not affect the rights of the assignee, paragraph (3) subjects a modification to the procedure foreseen in article 22 (2) for the modification of the original contract after notification of the assignment (i.e. to actual or constructive consent by the assignee; see para. 157).

Article 22. Modification of the original contract

(1) An agreement concluded before notification of the assignment between the assignor and the debtor that affects the assignee's rights is effective as against the assignee and the assignee acquires corresponding rights.

(2) After notification of the assignment, an agreement between the assignor and the debtor that affects the assignee's rights is ineffective as against the assignee unless:

(a) The assignee consents to it; or

(b) The receivable is not fully earned by performance and either modification is provided for in the original contract or, in the context of the original contract, a reasonable assignee would consent to the modification.

(3) Paragraphs (1) and (2) of this article do not affect any right of the assignor or the assignee for breach of an agreement between them.

References

A/CN.9/420, para. 109
A/CN.9/432, paras. 210-217
A/CN.9/434, paras. 198-204
A/CN.9/447, paras. 122-135
A/CN.9/456, paras. 205 and 206
A/CN.9/466, paras. 141 and 142

Commentary

154. In practice, the original contract may often need to be modified, for various reasons (e.g. equipment or materials different from the ones agreed may be necessary in the construction of a project). The effects of such contract modifications as between the assignor and the debtor, or as between the assignor and the assignee, are addressed in the relevant contract. In recognition of party autonomy in this regard, article 22 does not interfere with the relationship between the assignor and the debtor or between the assignor and the assignee. Accordingly, the requirements and the legal consequences of an effective modification agreement as between the assignor and the debtor remain subject to the law governing that agreement and any rights that the assignee might have against the assignor for breach of contract are not affected (see para. 158). However, article 22 deals with the third-party effects of such contract modifications that may be addressed only by way of legislation and are regulated only in a few jurisdictions. To address those third-party effects, article 22 provides, on the one hand, that the debtor has as against the assignee the right to modify the original contract and, on the other hand, that the assignee acquires rights as against the debtor under the modified original contract. Accordingly, if the price of the goods or services offered under the original contract is modified, the debtor may not raise the modification of the contract as a defence, asserting that the assignee has no rights under the new modified contract, and refuse to pay even the reduced price. Similarly, payment of the reduced price would discharge the debtor’s obligation.

155. The basic rule introduced by article 22 is that, before notification, the assignor and the debtor may freely modify their contract. They do not need to obtain the consent of the assignee, even though the assignor may have undertaken in the assignment contract to abstain from any contract modifications without the consent of the assignee or may be under the good faith obligation to inform the assignee about a contract modification. The breach of such an undertaking may give rise to liability of the assignor as against the assignee. It does not, however, invalidate an agreement modifying the original contract, since such an approach would inappropriately affect the rights of the debtor. After notification, a modification of the original contract becomes effective as against the assignee subject only to the actual or constructive consent of the assignee. The underlying rationale is that, after notification, the assignee becomes a party to a triangular relationship and any change in that relationship that affects the assignee's rights should not bind the assignee against its will. This approach is in line with article 19, according to which, before notification, the debtor may discharge its obligation in accordance with the original contract.

Modification before notification of the debtor

156. Paragraph (1) requires an agreement between the assignor and the debtor, which is concluded before notification of the assignment and affects the assignee's rights. If the agreement does not affect the rights of the assignee, paragraph (1) does not apply. If the agreement is concluded after notification, paragraph (2) applies. Under article 18, the relevant point in time is the time when notification is received by the debtor, since as of that time the debtor may discharge its obligation only in accordance with the assignee's payment instructions.

Modification after notification of the debtor

157. Paragraph (2) is formulated in a negative way, since the rule is that, after notification, a modification is ineffective as against the assignee, unless an additional requirement is met. "Ineffective" means that the assignee may claim the original receivable and the debtor is not fully discharged by paying less than the value of the original receivable. Paragraph (2) requires actual or constructive consent of the assignee. Actual consent is required if the receivable has been fully earned by performance and the assignee has thus the reasonable expectation that it will receive payment of the original receivable. For the purposes of the draft Convention, a receivable is considered as being fully earned when an invoice is issued, even if the relevant contract has only partially been performed. As a result, for such partially performed contracts to be modified, the actual consent of the assignee is required. Constructive consent exists if the original contract allows modifications or a reasonable assignee would have given its consent. Such a consent is sufficient if the receivable is not fully earned and the modification is foreseen in the original contract or a reasonable assignee would have consented to such a modification. In requiring actual or constructive consent, the Working Group intended to establish an appropriate balance between certainty and flexibility. If a receivable is fully earned, its modification affects the reasonable expectations of the assignee and has thus to be subject to the actual consent of the assignee. If, on the other hand, a receivable is not fully earned, there is no need to overburden the parties with requirements that may affect the efficient operation of a contract. In particular, in long-term contracts, such as project financing or debt-restructuring arrangements (in which receivables are offered as security in return for a reduction in the interest rate or an extension of the maturity date), a requirement that the assignor would have to obtain the assignee's consent to every little contract modification could slow down the operations while creating an unwelcome burden for the assignee. This problem would normally not arise, since in practice parties tend to resolve such issues through an agreement as to which types of modifications require the assignee's consent. In the absence of such an agreement or in the case of breach of such an agreement by the assignor, paragraph (2) would provide an adequate degree of protection to the debtor.

Assignor's liability for breach of contract

158. Paragraph (3) is intended to preserve any right the assignee may have under other law as against the assignor if a modification of the original contract violates an agreement between the assignor and the assignee. This means that, if, under article 22, a modification is effective as against the assignee without its consent, the debtor is discharged by paying in accordance with the contract as modified. The assignee, however, may turn against the assignor and claim the balance of the original receivable and compensation for any additional damage suffered, if the modification is in breach of an agreement between the assignor and the assignee under the law applicable to the agreement.

Article 23. Recovery of payments

Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located and the debtor's rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

References

A/CN.9/420, paras. 145-148
A/CN.9/432, paras. 239-244
A/CN.9/434, paras. 94 and 213-215
A/CN.9/447, paras. 136-139
A/CN.9/456, paras. 207 and 208
A/CN.9/466, paras. 143 and 144

Commentary

The rule: no recovery of payments from the assignee

159. In practice, the debtor may pay the assignee before the assignor performs its obligations under the original contract. If the assignee does not perform, the question arises whether the debtor may recover from the assignee the sums paid. This question is of particular importance if the assignor becomes insolvent and thus recovery of payments from the assignor is impossible. Article 23 provides that, if the debtor pays the assignee and the assignor does not properly perform the original contract, the debtor cannot turn against the assignee; it is left with any cause of action it might have against the assignor under the original contract and the law governing that contract. As a result, the debtor bears the risk of insolvency of its contractual partner, which would be the case anyway in the absence of an assignment. Noting that article 10 of the Ottawa Convention follows this approach only if the debtor has a cause of action against the assignor and provides for exceptions in the case of unjust enrichment or bad faith on the part of the assignee, the Working Group thought that the difference was justified. A right of the debtor to recover payments from the assignee operates as a guarantee by the assignee that the assignor will perform the original contract. Such a guarantee may be appropriate in the specific factoring situations addressed in the Ottawa Convention, but was thought to be inappropriate in the context of the wide range of financing or service transactions covered by the draft Convention.

Exceptions

160. In line with the principle that the draft Convention is not intended to override consumer protection law, article 23 preserves any right that the consumer debtor might have, under the law of the country in which it is located, to declare the original contract avoided and to recover from the assignee any payments made to the assignee (for consumer receivables and consumer protection, see paras. 36, 100, 128, 152 and 196). The reference to article 20 appears to introduce a second exception. In the case of payments in instalments, the debtor’s defences and rights of set-off with respect to outstanding instalments are preserved. The Commission may wish to consider whether this result is already sufficiently clear in article 20.

Section III. Other parties

Commentary

Structure of section III

161. Articles 24 (law applicable to priority issues) and 25 (public policy) are private international law rules. Article 26 (special proceeds rules) is a mixed private international law and substantive law rule and article 27 (subordination) is a substantive law rule. Articles 25, 26 and 27 are intended to qualify the application of article 24. Article 25 appears before article 26 not because it does not equally apply to situations dealt with in article 26, but because article 26, with respect to private international law matters, refers back to article 24 and, with respect to substantive law matters, it is a self-standing rule. Article 25 is not intended to limit the application of the special substantive law priority rule in article 27.

Article 24. Law applicable to competing rights of other parties

With the exception of matters which are settled elsewhere in this Convention, and subject to articles 25 and 26, the law of the State in which the assignor is located governs:

(a) The extent of the right of an assignee in the assigned receivable and the priority of the right of the assignee with respect to competing rights in the assigned receivable of:

(i) Another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) A creditor of the assignor; and

(iii) The insolvency administrator;

(b) The existence and extent of the right of the persons listed in paragraph (1) (a) (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) Whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

References

A/CN.9/420, paras. 149-164
A/CN.9/432, paras. 245-260
A/CN.9/434, paras. 238-258
A/CN.9/445, paras. 18-29 and 30-40
A/CN.9/455, paras. 18-34
A/CN.9/456, paras. 209-213
A/CN.9/466, paras. 20-24 and 32-35

Commentary

162. Article 24 is one of the most important provisions of the draft Convention. It is intended to serve the main goal of the draft Convention to facilitate increased access to lower-cost credit by enhancing certainty as to the relative rights of competing claimants. This result is achieved not by way of a substantive law priority rule

(as to the meaning of the term "priority", see paras. 63-65), since the Working Group was not able to reach consensus on such a rule (for substantive law priority rules, see, however, articles 26 and 27, the annex and article 40). Rather it is achieved by way of a private international law rule subjecting conflicts of priority to the law of a single and easily determinable jurisdiction (the law of the assignor's location; for the meaning of the term "location", see paras. 66-70). Such a rule constitutes a significant improvement of the present situation in which assignees tend either to reject international receivables as security for credit or accept them at a low value or only with additional security, since they either cannot determine which law may govern priority or have to meet the requirements of several jurisdictions in order to ensure priority.

"With the exception of matters which are settled elsewhere in this Convention"

163. The opening words of article 24 are intended to ensure that article 24 would apply only to matters that are not settled by way of a substantive law rule of the draft Convention. For example, the general effectiveness of an assignment of future receivables or notification of the assignment is addressed in article 9; the question whether, in the case of receivables arising or being earned after the commencement of an insolvency proceeding with respect to the assignor, the assignee has priority is left to the law of the assignor's location. As a result, an assignment of a receivable not existing at the time of notification is effective as between the assignor and the assignee. Similarly, an assignment is effective as against the debtor, even in the absence of a notification, and, if national law requires notification for priority reasons, notification has to be given under the draft Convention (it may thus relate to receivables not existing at the time of notification, even if national law does not allow notification with respect to such receivables). Furthermore, an assignment is effective in the absence of registration (even if national law makes registration a condition of effectiveness and requires a specific description of the assigned receivable). However, priority will be determined on the basis of registration, if the law of the assignor's location so provides (whether the receivable needs to be specifically described for the purpose of obtaining priority through registration is left to the law of the assignor's location). Issues of formal validity (e.g. whether a writing, notification or registration is required for the assignment to be effective *inter partes*) are left to law outside the draft Convention (for a Secretariat suggestion to address this matter, see para. 82); as are issues of material validity other than those addressed in articles 9 to 12.

"Subject to articles 25 and 26 "

164. The matters mentioned in article 24 are referred to the law of the assignor's location unless a rule of that law is manifestly contrary to the public policy of the forum or there is a super-priority right under the law of the forum. In the former case, the balance of the law of the assignor's location applies. In the latter case, the super-priority right, which under the law of the forum has priority, is given priority. The Commission may wish to consider whether the application of article 24 should also be subject to the absence of a subordination agreement (article 27). Alternatively, the Commission may wish to consider that, in view of the fact that article 27 is a substantive law rule, the opening words of article 24 ("With the exception of ...") are sufficient to cover matters settled in article 27 (although article 26 is also a substantive law rule and the application of article 24 is made subject to article 26).

Extent of a right and priority in receivables

165. Article 24 (a) draws a clear distinction between priority and the extent of the assignee's rights. The words "extent of a right" are intended to reflect whether an assignment by way of security or an outright assignment is involved and the *in rem* or *ad personam* nature of a right as against third parties (the proprietary effects of an assignment as between the assignor and the assignee are settled in article 9). Priority, on the other hand, deals with the question of who obtains payment first. In a conflict between a claimant with priority, who has a personal right, and a claimant, with a right *in rem*, the claimant with priority will prevail. However, in the

case of insolvency, such a prevailing claimant would be paid *pari passu* with other creditors with a personal right, while it would be paid before those creditors if it had a right *in rem*.

Conflicts between assignees in the case of duplicate assignments

166. Conflicts between assignees of the same receivables from the same assignor arise in the case of "duplicate assignments". Such assignments are normal practice in the case of assignments by way of security in which the same receivables are offered to different lenders as security for various amounts of credit. However, duplicate outright assignments may be a fraudulent or an unconscionable act. While fraud may be a rare occurrence, simple inadvertence on the part of the assignor, or ignorance of the legal effects of a previous assignment, occurs frequently. A typical example is the assignment to a receivables financier in return for working capital and to an inventory financier or to a supplier of materials on credit with a retention of title or other security interest until full payment of the price of the inventory or of the materials. In such a case, the conflict may be between a global assignment (an assignment of all present and future receivables) to the receivables financier and an assignment to the inventory financier or the supplier of the proceeds from the sale of the inventory or materials.

Conflicts between Convention and non-Convention assignees

167. Article 24 (a) (i) explicitly provides that a conflict between a Convention and a non-Convention assignee (e.g. between a foreign and a domestic assignee of domestic receivables) is also covered (however, a conflict between an assignee in a Contracting State and an assignee in a non-Contracting State is not covered). Such an approach avoids any negative impact on domestic law and practice. In fact, one of the reasons for which the Working Group decided to turn the priority rules into private international law rules was that such rules would not negatively affect domestic practices. The draft Convention does not give priority to a foreign assignee over a domestic assignee. It merely refers conflicts of priority to the law of the assignor's location. With one possible exception (see para. 20), that law would be the law the requirements of which the domestic assignee of a domestic receivable would have to meet to obtain priority, whether the draft Convention applies or not.

Conflicts with the assignor's creditors or the insolvency administrator

168. A creditor of the assignor or the insolvency administrator may have a competing right with the assignee, if, after the assignment, that creditor obtains a court judgement attaching the receivables in the hands of the assignor (if the assignment is made after attachment or the commencement of an insolvency proceeding, no conflict arises; any rights that the assignee may obtain are subordinate to the rights of the assignor's creditors or the insolvency administrator). If priority is based on the time of assignment, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is sufficient to establish that the receivables are separated from the assignor's estate (if an outright assignment is involved) or that the assignee may satisfy its claim in preference to unsecured creditors (if an assignment by way of security is involved). If, however, priority is determined on the basis of notification of the debtor or registration of certain data about the assignment in a public registry, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is not sufficient for the purpose of establishing priority. Notification of the debtor or registration also needs to take place before attachment or commencement of the insolvency proceeding.

Insolvency of the assignee or the debtor

169. Issues arising in the case of insolvency of the assignee are beyond the scope of the draft Convention and are not addressed, unless the assignee makes a subsequent assignment and becomes an assignor. The draft Convention is not intended to address issues arising in the context of the debtor's insolvency either. It is

assumed that the assignee would have in the receivables the same rights that the assignor would have in the case of insolvency of the debtor.

"The existence and extent of the right ... and the priority of a right" in proceeds

170. In line with subparagraph (a), subparagraph (b) provides that the law of the assignor's location governs the extent of the rights of the persons mentioned above and the priority of such rights with respect to proceeds. Proceeds include, under article 6 (k), proceeds of receivables and proceeds of proceeds. Therefore, the words "of the assigned receivable" may need to be deleted, so as to avoid creating the impression that only proceeds of receivables are covered in article 24 (b). The words "the extent of the right" relate to the *in rem* or *ad personam* nature of the assignee's rights in proceeds. The Commission may wish to consider whether the word "existence", which was added at the thirty-first session of the Working Group without any discussion, should be retained (see A/CN.9/466, para. 212). It would seem that subparagraph (b) goes far beyond subparagraph (a), in that it covers, with respect to proceeds, issues that the draft Convention does not address even with respect to receivables, namely, substantive validity in every respect and formal validity matters. If article 24 (b) is retained unchanged, the title of the article may need to be revised.

The existence and the extent of rights in receivables that are proceeds of other property

171. The extent of any rights and the priority of such rights in receivables that are proceeds of other receivables is subject to the law of the assignor's location by virtue of article 24 (a) (i), if such rights are created by agreement, or by virtue of article 24 (a) (ii), if such rights are created by operation of law. Depending on whether the Commission decides to retain the reference to the "existence" of such rights, it may wish to merge subparagraph (c) into subparagraph (a) (ii) or to delete subparagraph (c) altogether and include a clarification of the matter in the commentary (for the meaning of the words "the extent of the right", see para. 165).

Applicable law

172. Departing from the approach traditionally followed in many legal systems, subjecting priority issues to the *lex situs* of the receivable (the law of the country where payment is due or the debtor is located), the Working Group decided to subject priority issues to the law of the assignor's location. The Working Group took this approach, considering that the traditional rule is no longer regarded as a workable or efficient rule. In the increasingly common case of a global assignment of present and future receivables, application of the law of the *situs* of the receivable fails to yield a single governing law. It also exposes prospective assignees to the burden of having to determine the notional *situs* of each receivable separately. Application of the law governing the receivable or of the law chosen by the parties produces similar results. Different priority rules would govern priority with regard to the various receivables in a pool of receivables and, in the case of future receivables, the parties would not be able to determine with any certainty the law applicable to priority, a factor that might defeat a transaction or, at least, raise the cost of credit. Application of the law chosen by the assignor and the assignee in particular could allow the assignor, acting in collusion with a claimant in order to obtain a special benefit, to determine the priority among several claimants. In addition, the law chosen by the parties would be completely unworkable in the case of several assignments of the same receivables either by the same or by different assignees, since different laws could apply to the same priority conflicts.

173. While the Working Group decided to depart from the traditional approach in order to accommodate the most common practices that involve bulk assignments of all present and future receivables, it decided that no exception should be made for assignments of single, high-value, existing receivables. It was widely felt that introducing a different priority rule with regard to the assignment of such receivables would detract from the certainty achieved in article 24. In addition, it would be very difficult to clearly define "high-value

receivables". Moreover, in a bulk assignment containing both "high-value"and "low-value" receivables, priority would be subject to different laws.

174. In view of the fact that, in the case of more than one place of business, location is defined by reference to the place of central administration of a legal entity, application of the law of the assignor's location will result in the application of the law of a single jurisdiction and one that can be easily determined at the time of the assignment. It will thus eliminate the difficulties mentioned above. In particular, the location of the assignor as a connecting factor presents the advantage that it provides a single point of reference; it can be ascertained at the time of even a bulk assignment of future receivables; it would be suitable even for legal systems in which registration is practiced; and it would result in the application of the law of the jurisdiction in which any main insolvency proceeding with regard to the assignor would be most likely to commence. This last aspect of the application of the law of the assignor's location is essential, since it appropriately addresses the issue of the relationship between the draft Convention and the applicable insolvency law.

175. With respect to insolvency, the thrust of article 24 is to ensure that, in most cases, the law governing priority under article 24 and the law governing the insolvency of the assignor are the laws of one and the same jurisdiction (the assignor's main jurisdiction). In such a situation, any conflict between the draft Convention and the applicable insolvency law would be resolved by the rules of law of that jurisdiction. In all other cases in which an insolvency proceeding with regard to the assets and affairs of the assignor is commenced in a State other than the State of the assignor's main jurisdiction (e.g. a jurisdiction in which the assignor has assets), the draft Convention gives way to rules of law that reflect the public policy of the State in which a dispute is adjudicated (article 25). Other special rights of the assignor's creditors or the insolvency administrator are not affected (see para. 182).

176. The Commission may wish to consider whether the application of the law of the assignor's location to priority issues in the case of receivables arising from deposit, securities or commodities accounts would be appropriate. In such practices, priority issues are normally subject to the law of the financial service provider's location. Introducing a different priority rule with regard to such practices may be in line with the normal expectations of parties. On the other hand, such an approach may introduce uncertainty, at least, to the extent that parties, in order to determine which priority rule applies, would need to discover the source of the assigned receivables, which would not be possible with respect to future receivables and would only be possible at some cost with respect to receivables assigned in bulk.

Limitations of applicable law rules

177. As a private international law provision, article 24 does not settle priority conflicts; it merely refers them to the law of the assignor's location. If, under that law, priority is based on the time of assignment, an assignee considering whether to finance certain receivables has to rely on the assignor's representations and possibly on representations made by other parties or on information available in a certain market. If the applicable law determines priority based on priority in notification of the debtor, again a prospective assignee has to rely on representations by the assignor and by the debtor, as well as on information available from other sources. In such jurisdictions, priority with regard to future receivables will not be obtainable at all at the time of assignment (at that time the identity of the debtors is not known), and priority with regard to receivables assigned in bulk will only be obtainable at the additional cost of notifying all the debtors. If, on the other hand, under the law applicable, priority is obtained by way of making certain data part of a public record, beyond representations by the assignor or other parties, prospective assignees would have that public record to rely on. In addition, assignees filing the required data would have an objective way of acquiring priority (for additional limitations to the application of the priority rules of the draft Convention, see paras. 177-180).

Time relevant for the determination of the location of the assignor

178. For the draft Convention, including article 24, to apply, the assignor has to be located in a Contracting State at the time of the conclusion of the contract of assignment. This approach enhances predictability as to the application of the draft Convention and facilitates decisions as to entering into and establishing the cost of a transaction. However, if the assignor makes an assignment in one country and another assignment in another country to which the assignor relocates, the draft Convention may not apply if the new location of the assignor is not in a Contracting State (article 24 (a) (i) is not intended to cover such situations) and, even if the draft Convention applies, the application of article 24 would be problematic since there would be two laws of the assignor's location. The Commission may, therefore, wish to consider that, in the case of relocation of the assignor or the receivable, a grace period should be introduced, during which the assignee with priority under the law of the initial location would not lose its priority. Such an approach would ensure that the rights of claimants in the new location would not for ever be subject to the rights of claimants from other jurisdictions. Such a transition rule would be necessary, since, with the current pace of mergers, moving the place of central administration of an entity may not be a rare occurrence. Dealing with the issue of relocation would be necessary, in particular, if location of an entity is defined by reference to the place where a receivable is booked. Moving receivables is certainly easier than moving places of central administration.

Article 25. Public policy and preferential rights

(1) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(2) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right that arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding article 24. A State may deposit at any time a declaration identifying those preferential rights.

References

A/CN.9/434, paras. 216-237
A/CN.9/445, paras. 41-44
A/CN.9/455, paras. 35-40
A/CN.9/456, paras. 214-222
A/CN.9/466, paras. 36-41

Commentary

Public policy

179. The policy underlying article 25 is to strike a balance between the need to ensure certainty as to the application of the law of the assignor's location and the need to preserve the fundamental policy decisions of the law of the forum. Accordingly, paragraph (1) recognizes the right of a court or other authority, whether in the context of insolvency or not, to set aside a provision of the law of the assignor's location and, at the same time, limits that right to cases in which that provision is "manifestly contrary" to the public policy of the forum State. The public policy meant in paragraph (1) is the international public policy of the forum State. Recourse to such public policy has only a negative effect in the sense that it may defeat the application of a provision of the law applicable under article 24 that is manifestly contrary to the public policy of the forum State (e.g. a rule giving priority to a foreign State for taxes). As a result, a certain person may be by-passed in the determination of priority, while priority will be determined by other provisions of the applicable law.

180. For a priority rule to be set aside under paragraph (1), it must be "manifestly contrary" to the public policy of the forum State. It is assumed that two jurisdictions are involved (i.e the forum is in a State other than

that of the assignor's location). If only one jurisdiction is involved, the rules of that jurisdiction would resolve the matter. The notion of "manifestly contrary" is used in international texts as a qualification of public policy (see, e.g., article 6 of the UNCITRAL Model Law on Cross-Border Insolvency, article 16 of the Rome Convention and article 18 of the Mexico City Convention). The purpose of such a qualification is to emphasize that public policy exceptions should be interpreted restrictively and paragraph (1) should be invoked only in exceptional circumstances concerning matters of fundamental importance for the forum State. Otherwise, the certainty achieved by article 24 could be seriously compromised, a result that would have a negative impact on the availability and the cost of credit on the basis of receivables (the term "manifestly contrary" is used also in article 32; see para. 199).

181. As mentioned above, the public policy of article 25 may not have a positive effect; it may not result in the positive application of a priority rule of the forum State that reflects public policy (e.g. a rule giving priority to employees in the forum State). For that reason, paragraph (2) specifically allows the forum State to apply its own priority rules, in the case where a priority rule applicable under paragraphs (1) and (2) is manifestly contrary to the forum's public policy, and to give priority to super-priority rights reflecting the forum's public policy (e.g. claims of the State for taxes or of employees for wages, but not security rights arising by contract or other property rights recognized in a court judgement). Paragraph (2) goes a step further. It allows (but creates no obligation for) a State to list in a declaration the super-priority rights that should prevail over the rights of an assignee under the draft Convention. This possibility for declarations is intended to enhance certainty in that it provides a mechanism for assignees to know which super-priority rights would prevail over their rights. The Commission may wish to reconsider the use of the term "preferential" (it may be broader than intended and confused with normal priority, which is defined in article 6 (h) as a preference).

Special insolvency rights

182. Article 25 makes no reference to special rights of creditors of the assignor or of the insolvency administrator that may prevail over the rights of an assignee under law governing insolvency. The reason is that priority established under the draft Convention is not intended to interfere with such special rights. Such special rights include, but are not limited to, any right of creditors of the assignor to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer. They also include any right of the insolvency administrator to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer; to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment of receivables that have not arisen at the time of the commencement of the insolvency proceeding; to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract; or to encumber the assigned receivables with the expenses of the insolvency administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee. If the assigned receivables constitute security for indebtedness or other obligations, the special rights protected include any rights existing under insolvency rules or procedures generally governing the insolvency of the assignor that permit the insolvency administrator to encumber the assigned receivables; provide for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding; permit the substitution of the assigned receivables for new receivables of at least equal value; or provide for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured.

Article 26. Special proceeds rules

(1) If proceeds of the assigned receivable are received by the assignee, the assignee is entitled to retain those proceeds to the extent that the assignee's right in the assigned receivable had priority over competing rights in the assigned receivable of the persons described in subparagraph (a) (i) to (iii) of article 24.

(2) If proceeds of the assigned receivable are received by the assignor, the right of the assignee in those proceeds has priority over competing rights in those proceeds of the persons described in subparagraph (a) (i) to (iii) of article 24 to the same extent as the assignee's right had priority over the right in the assigned receivable of those persons if:

(a) The assignor has received the proceeds under instructions from the assignee to hold the proceeds for the benefit of the assignee; and

(b) The proceeds are held by the assignor for the benefit of the assignee separately and are reasonably identifiable from the assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

References

A/CN.9/447, paras. 63-68 A/CN.9/466, paras. 42-53
A/CN.9/456, paras. 160-167

Commentary

183. Article 26 is intended to introduce a limited substantive law priority rule with respect to proceeds. Proceeds include proceeds of proceeds (the words "of the assigned receivable" may, therefore, need to be deleted), but not returned goods (as between the assignor and the assignee, rights in proceeds and returned goods are settled in article 16 (1) (c)).

Proceeds received by the assignee

184. Under paragraph (1), the assignee may retain any proceeds received by the assignee (in other words, the assignee has a right *in rem*), if the assignee has priority with respect to the assigned receivable. The implicit limitation, which may need to be stated explicitly (as in article 16 (3)), is that the assignee may not retain more than the value of its receivable. Paragraph (1), however, may inadvertently result in granting an assignee priority with respect to proceeds of proceeds even if another person has priority with respect to proceeds of the assigned receivable under the law of the assignor's location. For example, if the debtor pays the assignor with a cheque, the assignor deposits the cheque in its bank account and then pays the assignee, under paragraph (1), the first assignee has a right to retain the cash (proceeds of proceeds) even if the depositary institution has priority in the balance in the deposit account (proceeds of the assigned receivable). The same inappropriate result may arise if the assignor receives payment by way of a security (e.g. a bond), the security is pledged to a second assignee and then its proceeds are paid to the first assignee. The first assignee could retain the proceeds of proceeds, even though the second assignee would normally have priority with respect to the proceeds of the assigned receivable under the law of the assignor's location. The Commission may, therefore, wish to introduce language in article 26 to ensure that an assignee's right in proceeds of proceeds does not affect the rights of another person in proceeds of the assigned receivable under the law of the assignor's location.

Proceeds received by the assignor

185. Under paragraph (2), the assignee has priority with respect to proceeds received by the assignor, if it has priority with respect to the assigned receivable and if the assignor receives payment on behalf of the assignee and keeps those proceeds separated from its own assets. This limited provision is aimed at facilitating practices, such as undisclosed invoice discounting and securitization, to the extent that such priority with respect to proceeds will increase certainty as to payment to the assignee, in particular in the case of insolvency. The Commission may wish to consider whether paragraph (2) is sufficient to achieve its objectives, since it

does not clearly refer the extent of a right (i.e. its *in rem* or *ad personam* nature) to the law of the assignor's location, as does article 24 (the *in rem* nature and the priority of a right are two distinct issues; see para. 165).

Article 27. Subordination

An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees.

References

A/CN.9/445, para. 29
A/CN.9/455, para. 31
A/CN.9/456, para. 210

Commentary

186. Article 27 is intended to recognize the interest of the parties, involved in a conflict in negotiating and relinquishing priority in favour of a subordinate claimant where commercial considerations so warrant. In order to afford maximum flexibility and to reflect prevailing business practices, article 27 makes it clear that a valid subordination need not take the form of a direct subordination agreement between the assignee with priority and the beneficiary of the subordination agreement. It can also be effected unilaterally, for instance, by means of an undertaking of the first ranking assignee to the assignor (whether in the contract of assignment or an independent, written or oral, agreement), empowering the assignor to make a second assignment ranking first in priority. The term "unilaterally" is further intended to clarify that the beneficiary of the subordination (the second assignee) need not offer consideration in exchange for the priority granted by the unilateral subordination. Furthermore, article 27 clarifies that an effective subordination need not specifically identify the intended beneficiary or beneficiaries ("any existing or future assignees") and can instead employ generic language. Such unilateral subordination may take place in an assignment between entities in the same corporate group or may be a service offered by a lender to a borrower for commercial considerations.

CHAPTER V. CONFLICT OF LAWS

References

A/CN.9/420, paras. 185-187
A/CN.9/445, paras. 52-55
A/CN.9/455, paras. 67-73
A/CN.9/466, paras. 145-149

Scope and purpose of chapter V

Commentary

187. Chapter V is intended to state a few general principles that are widely adopted but not recognized in all legal systems. It is not intended to deal with all assignment-related issues in an exhaustive way, or to displace or to contradict any existing international legislative text. Articles 28, 29, 31 and 32 reflect generally accepted principles (e.g., the Mexico City Convention or article 12 of the Rome Convention, with the exception of the requirement for an express choice in article 28 (1) and the rebuttable presumption in favour of the assignor's location in article 28 (2)). The fact that those principles may already be accepted in the law of some States does not reduce their usefulness for other States. Furthermore, in the absence of those provisions, a great

degree of uncertainty would remain with regard to the law applicable to all those issues that are left, by necessity, to law other than the draft Convention (for a non-exhaustive list of those issues, see para. 79).

188. Article 30, which is intended to extend the application of the principles embodied in articles 24 to 26 to transactions falling outside the ambit of the draft Convention, breaks new ground in addressing an issue that is not clearly or appropriately resolved in current law. In this respect, the Working Group carefully considered article 12 of the Rome Convention and concluded that, in view of the uncertainty as to whether article 12 covers priority issues and, if it does, as to which is the applicable law, it is necessary to address this matter in the draft Convention. The basic premise of article 30, namely, that priority issues are to be referred to the law of the assignor's location, has been adopted by consensus in articles 24 to 26. The question pending relates to the exact scope of this rule. While chapter V seems to be more or less acceptable in substance, it appears to be objectionable to some States for general legislative policy reasons (relating, e.g., to the questions whether it is good policy to have general private international law rules in a primarily substantive law text, whether UNCITRAL is the appropriate body to prepare private international law rules or whether that matter should be left to other international or regional organizations). In order to address those policy concerns, chapter V has been made subject to an opt-out. The deletion of chapter V or the limitation of its scope, however, would reduce the benefits to be derived from it by States that need it, without providing any additional protection to States that do not need it. Similarly, making chapter V subject to an opt-in could inadvertently result in limiting its scope of application, since an opt-in approach might discourage States from adopting chapter V.

189. As a matter of drafting, the Commission may wish to consider whether article 1 (3), specifying the scope of chapter V and providing for an opt-out by States, should be placed at the beginning of chapter V, along with a provision dealing with the hierarchy between the substantive and the private international law provisions of the draft Convention (see para. 22). The Commission may also wish to consider whether the title of chapter V should be revised to read along the following lines: "Other conflict-of-laws rules" (articles 24 to 26 are also conflict-of-laws rules). Alternatively, the Commission may wish to place all conflict-of-laws rules in one chapter. If such an approach were to be adopted, article 30 could be deleted and articles 24 to 26 would need to be made subject to an opt-out but only to the extent they would apply irrespective of whether the assignor was located in a Contracting State.

Article 28. Law applicable to the rights and obligations of the assignor and the assignee

(1) [With the exception of matters that are settled in this Convention,] the rights and obligations of the assignor and the assignee under the contract of assignment are governed by the law expressly chosen by the assignor and the assignee.

(2) In the absence of a choice of law by the assignor and the assignee, their rights and obligations under the contract of assignment are governed by the law of the State with which the contract of assignment is most closely connected. In the absence of proof to the contrary, the contract of assignment is presumed to be most closely connected with the State in which the assignor has its place of business. If the assignor has more than one place of business, reference is to be made to the place of business most closely connected to the contract. If the assignor does not have a place of business, reference is to be made to the habitual residence of the assignor.

(3) 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 to the extent that that law cannot be derogated from by contract.

References

A/CN.9/420, paras. 188-196 A/CN.9/455, paras. 67-119

A/CN.9/445, paras. 52-74 A/CN.9/466, paras. 150-153

Commentary

190. Article 28 is intended to reflect the principle of party autonomy with respect to the law applicable to the contract of assignment (a principle reflected in articles 12 of the Rome Convention and 7 of the Mexico City Convention). While being widely recognized, this principle is not universally accepted. Pending final determination by the Commission of the exact scope of chapter V, the opening words of article 28 appear within square brackets (if the suggestion made by the Secretariat in para. 23 is adopted, these words could be deleted). Paragraph (1) provides that the choice of law must be express. The Working Group recognized that an implicit choice would be in line with current trends in private international law (see articles 3 (1) of the Rome Convention and 7 of the Mexico City Convention). However, it was widely felt that a an express choice should be required in the case of financing transactions, in which certainty was of utmost importance and might determine whether a transaction would take place and at what cost. The Commission may wish to reconsider this matter. It would appear that validating a choice of law that could be "clearly implied from the contract" would not seriously compromise certainty, while it would make article 28 more acceptable to some States.

191. Under paragraph (1), the proper law of the contract governs the purely contractual aspects of the contract of assignment (e.g. conclusion and the substantive validity, the interpretation of its terms, the assignee's obligation to pay the price or to render the promised credit, the existence and effect of representations as to the validity and enforceability of the debt). Paragraph (1), however, is not intended to cover the substantial validity aspects addressed in the draft Convention with respect to assignments falling within its ambit (this is the purpose of the opening words) or other substantive validity aspects, such as capacity or authority to act. The issue is important, since, in some countries, the capacity to effect a bulk assignment is confined to corporations or to assignments made in the course of business of the assignor. It is not sufficiently clear whether article 9 would override such statutory prohibitions relating to capacity. Nor is it clear which law would apply to such statutory prohibitions. While most assignments under the draft Convention should be made by assignors in the course of business, leaving this matter unaddressed leaves a residual area of uncertainty (for a suggestion by the Secretariat to address the question of the law applicable to statutory assignability, see para. 196). Paragraph (1) is not intended to cover the financing contract either, if the contract of assignment is just a clause in the financing contract, unless the parties agree otherwise. Furthermore, paragraph (1) does not cover the proprietary aspects of assignment (for this reason, reference is made to "the contract of assignment" as opposed to "the assignment" itself; for this distinction, see paras. 24 and 25). The Working Group agreed that it would not be appropriate to submit the transfer of property rights to the proper law of the contract. With respect to assignments falling within the ambit of the draft Convention, such proprietary aspects are, to a large extent, dealt with in the provisions of the draft Convention outside chapter V.

192. Paragraph (2) is intended to deal with the exceptional situations in which the parties have not expressly agreed on the law applicable to the contract of assignment or in which the parties have agreed but their agreement is later found to be invalid. It refers to the closest-connection test, which may result in the application of the law of the assignor's location (e.g. in the case of an assignment by way of sale) or of the law of the assignee's location (e.g. in an assignment by way of security made in the context of a credit transaction). In an attempt to combine flexibility with certainty, paragraph (2) introduces a rebuttable presumption that the State with the closest connection to the contract is the law of the assignor's location. Location in this context means place of business. In view of the limited scope of application of paragraph (2), the Working Group thought that such a reference to the place of business would not undermine the certainty necessary for financing transactions. In creating a specific presumption in favour of the law of the assignor's location, article 28 is not necessarily in conflict with practice followed in other private international law texts that refer, for example, to the place where the party who is to effect the characteristic performance has its habitual residence or place of

business (article 4 (2) of the Rome Convention) or to "all subjective and objective elements of the contract" (article 9 of the Mexico City Convention). Such conflicts could arise in those cases in which application of the characteristic-performance test would not yield a presumption in favour of the law of the assignor's location. In complex financing transactions, however, where the payment of money and the provision of services or reciprocal obligations are involved, the characteristic-performance test may not be as effective in determining the most closely connected law in any realistic sense. In any case, the parties can select the applicable law. Furthermore, the presumption may be rebutted if the circumstances show that the contract is more closely connected with another country.

193. Paragraph (3) is intended to restrict party autonomy in the sense that the parties to a purely domestic contract may not set aside the mandatory rules of the law of the State with which the contract is connected. If the contract is not purely domestic, restrictions to party autonomy are to be found in articles 31 and 32. If chapter V is to apply to international assignments or to assignments of international receivables as defined in chapter I, the scope of this rule would be limited to cases where a domestic assignment of a domestic receivable may fall within the ambit of the draft Convention (i.e. in the case of a subsequent assignment in a chain of assignments in which a prior assignment is governed by the draft Convention). Even if chapter V applies independently of chapter I, its scope would be limited, since there would always need to be an international element for the application of private international law provisions to be triggered in the first place. The international element could relate to the contract of assignment as such or to the assigned receivable. The Commission may wish to consider whether this matter should be explicitly clarified in paragraph (3) (e.g. article 3 (3) of the Rome Convention refers, not only to "the contract", but to "all elements relevant to the situation at the time of the choice of a foreign law"). The Commission may also wish to consider whether paragraph (3) should refer consistently to the connection between a State and the contract of assignment (and not the assignment).

Article 29. Law applicable to the rights and obligations of the assignee and the debtor

[With the exception of matters that are settled in this Convention,] the law governing the receivable to which the assignment relates determines the enforceability of contractual limitations on assignment, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged.

References

A/CN.9/420, paras. 197-200
A/CN.9/445, paras. 65-69
A/CN.9/455, paras. 92-104 and 117
A/CN.9/466, paras. 154-158

Commentary

194. In line with the approach that an assignment should not change the legal position of the debtor, article 29 refers issues arising in the context of the relationship between the assignee and the debtor to the law governing the receivable. The proper law of the original contract is meant, not the notional *lex situs* of the debt. The Commission may wish to clarify this matter explicitly in article 29 (and in article 1 (2)). Such an approach would be justified, since, unlike article 12 (2) of the Rome Convention on which article 29 was modelled and which may apply to non-contractual rights, article 29 covers only contractual receivables. The Working Group decided to avoid specifying how the proper law of the original contract should be determined. It was widely felt that such elaborate rules were not necessary in a chapter that was intended to establish some general rules, without addressing all assignment-related private international law issues. It was also generally thought that it would be inappropriate to attempt to determine the law governing the wide variety of contracts that might be at the origin of a receivable (e.g. contracts of sale, insurance contracts or contracts relating to

financial markets operations). Pending final determination by the Commission of the exact scope of chapter V, the opening words of article 29 appear within square brackets (if the Secretariat suggestion in para. 23 is adopted, these words could be deleted).

195. It would appear that article 29 also applies to transaction set-off (i.e. a cross-claim arising out of the original contract or a related contract), since a transaction set-off would fall either under the "relationship between the assignor and the debtor" or "the conditions under which the assignment can be invoked against the debtor". The Commission may wish to clarify this matter. Independent set-off (i.e. claims arising from sources that are unrelated to the original contract), however, is not covered. Such claims may arise from a variety of sources (e.g., a separate contract between the assignor and the debtor, a rule of law or a judicial or arbitral decision). Their availability and the conditions governing availability (e.g. liquidity, same currency and maturity) are left to other law. The Working Group considered the law governing the original contract or the contract from which a contractual independent right of set-off might arise, but was unable to reach consensus.

196. Article 29 also covers contractual, but not statutory, assignability as an issue relating to payment by and discharge of the debtor. As a result, in cases where the debtor's rights and obligations are governed by the draft Convention, the assignment is effective as against the debtor, even if there is a limitation on assignment in the original contract (article 11 (1)) and the debtor will not have a defence as against the assignee (article 20 (3)). If the draft Convention does not apply with regard to the debtor, the effects of a contractual limitation on the relationship between the assignee and the debtor are left to the law governing the receivable. The term "enforceability" is intended to reflect both the effectiveness of a contractual limitation both as between the parties thereto and as against third parties (i.e. to validity *inter partes* and effectiveness *erga omnes)*. For consistency reasons and in order to avoid questions of interpretation (the term "enforceability" appears to exclude the notion of validity *inter partes*), the Commission may wish to consider substituting the term "effectiveness" for the term "enforceability". The Commission may wish to reconsider the issue of the law applicable to statutory assignability. The law of the assignor's location or the law governing the receivable may be considered. The restriction as to the mandatory rules or the public policy of the forum would be sufficient to ensure that the applicable law would not apply to cases to which it should not apply (e.g., the law governing the receivable may not be appropriate in the case of statutory prohibitions aimed at protecting the assignor). Article 29 does not refer consumer-protection issues to the law of the debtor's location. Article 31, which gives a court the discretion to apply any mandatory rules of the forum or of a closely connected law, should be sufficient to preserve the application of consumer-protection law (for consumer receivables and consumer protection, see paras. 36, 100, 128, 152 and 160).

[*Article 30. Law applicable to competing rights of other parties*

(1) The law of the State in which the assignor is located governs:

(a) The extent of the right of an assignee in the assigned receivable and the priority of the right of the assignee with respect to competing rights in the assigned receivable of:

(i) Another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) A creditor of the assignor; and

(iii) The insolvency administrator;

(b) The existence and extent of the right of the persons listed in paragraph (1) (a) (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) Whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

(2) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(3) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right which arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding paragraph (1) of this article. A State may deposit at any time a declaration identifying those preferential rights.]

References

A/CN.9/445, paras. 70-74
A/CN.9/455, paras. 105-110
A/CN.9/466, paras. 159 and 160

Commentary

197. Like articles 31 and 32, article 30 appears within square brackets pending determination by the Commission of the scope or purpose of chapter V. Retention of article 30 is meaningful only if chapter V is to apply to transactions beyond those falling within the scope of the draft Convention under chapter I. If chapter V has the same scope as the other parts of the draft Convention, article 30 repeats rules reflected in articles 24 to 27 and may thus be deleted. If chapter V is to apply irrespective of chapter I, article 30 would need to be retained. In addition, article 30 may need to specify that it applies also to conflicts involving a subsequent assignment as if the subsequent assignee is the initial assignee (this matter is addressed in chapter I, article 2 (b)). Furthermore, paragraph (2) may be deleted as superfluous, since the matter dealt with in paragraph (2) is addressed in article 32. As a private international law rule, article 30 has the goal of providing certainty with regard to the law applicable to conflicts of priority. Such certainty is dependent upon making reference to the law of a single and easily determinable jurisdiction (see paras. 172-176). Priority is defined in article 5 (i) as a preference (in payment or other discharge) and article 30 specifies the parties between which such conflicts may arise. In view of the fact that the debtor is not one of those parties, priority does not relate to the debtor's discharge. Therefore, the debtor being discharged under the law governing the receivable cannot be asked to pay again the party with priority under the law of the assignor's location.

[*Article 31. Mandatory rules*

(1) Nothing in articles 28 and 29 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

(2) Nothing in articles 28 and 29 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable.]

References

A/CN.9/455, paras. 111-117 A/CN.9/466, paras. 161 and 162

Commentary

198. Paragraph (1) is intended to reflect a generally accepted principle in private international law, according to which the mandatory law of the forum may be applied irrespective of the law otherwise applicable (see article 7 of the Rome Convention and article 11 of the Mexico City Convention). Mandatory law in this context does not refer to law that cannot be derogated from by agreement (as in article 28 (3)), but to law of fundamental importance, such as consumer protection law or criminal law (*loi de police*). Paragraph (2) introduces a different rule, namely, that a court in a Contracting State may apply neither its own law nor the law applicable under articles 28 and 29, but the law of a third country, on the ground that the matters settled in those provisions have a close connection with that country (it is derived from article 7 (1) of the Rome Convention, which is subject to a reservation, while more recent private international law texts include no such reservation). The scope of article 31 is limited to cases involving the law applicable to the contract of assignment and to the relationship between the assignee and the debtor. As to whether the law applicable to priority issues may be set aside as contrary to mandatory law rules of the forum State, it was generally thought that article 30 (3), under which a priority rule of the law applicable may be set aside for the purpose of protecting, for example, a right of the forum State for taxes, was sufficient. Such a limitation of the mandatory-law exception was thought to be warranted, since priority rules are of a mandatory nature and setting them aside in favour of the mandatory rules of the forum or another State would inadvertently result in uncertainty as to the rights of third parties, a result that would have a negative impact on the availability and the cost of credit.

[*Article 32. Public policy*

With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.]

References

A/CN.9/455, paras. 118 and 119 A/CN.9/466, paras. 163 and 164

Commentary

199. Article 32 differs from article 31 in that article 32 has only a negative effect, namely, that of setting aside a rule of the applicable law, if it is manifestly contrary to the international public policy of the forum (on this matter, see para. 180; see also article 16 of the Rome Convention and article 18 of the Mexico City Convention). In line with the approach followed in other international legal texts, the qualification "manifestly" has been added before the words "contrary to public policy". It should be noted that it is the application of the applicable law to a particular case and not the applicable law itself that needs to be manifestly contrary to the public policy of the forum. The application of a foreign law, therefore, cannot be refused on the ground that the law itself, in general, is considered to be inimical to the public policy of the forum, but only if the application of a particular rule in a concrete case would be repugnant to the public policy of the forum.

CHAPTER VI. FINAL PROVISIONS

Article 33. Depositary

The Secretary-General of the United Nations is the depositary of this Convention.

References

A/CN.9/455, paras. 124 and 125

Commentary

200. The Treaty Section of the Office of Legal Affairs of the United Nations , located at United Nations Headquarters in New York, performs the depositary functions of the Secretary-General. Treaties deposited with the depositary are accessible through the home page of the Treaty Section on the World Wide Web (http:\\www.un.org\depositary).

Article 34. Signature, ratification, acceptance, approval, accession

(1) This Convention is open for signature by all States at the Headquarters of the United Nations, New York, until ... .

(2) This Convention is subject to ratification, acceptance or approval by the signatory States.

(3) This Convention is open to accession by all States which are not signatory States as from the date it is open for signature.

(4) Instruments of ratification, acceptance, approval and accession are to be deposited with the Secretary-General of the United Nations.

References

A/CN.9/455, paras. 141 and 142

Commentary

201. The Commission may wish to consider the length of the time period during which the draft Convention should be open for signature by States. In conventions prepared by UNCITRAL, this period ranges from one year (in the case of the United Nations Convention on the Carriage of Goods by Sea, 1978 and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade) to two and a half years (in the case of the United Nations Convention on International Bills of Exchange and International Promissory Notes).

Article 35. Application to territorial units

(1) If a State has two or more territorial units in which different systems of law are applicable in relation to the matters dealt with in this Convention, it may, at any time, declare that this Convention is to extend to all its

territorial units or only one or more of them, and may at any time substitute another declaration for its earlier declaration.

(2) These declarations are to state expressly the territorial units to which the Convention extends.

(3) If, by virtue of a declaration under this article, this Convention does not extend to all territorial units of a State and the assignor or the debtor is located in a territorial unit to which the Convention does not extend, this location is considered not to be in a Contracting State.

(4) If a State makes no declaration under paragraph (1) of this article, the Convention is to extend to all territorial units of that State.

References

A/CN.9/455, paras. 143 and 144

Commentary

202. Article 35 is intended to ensure that a federal State may adopt the draft Convention, even if, for any reason, it does not wish to have it apply to one or more territorial units. Such a right is particularly important for States with more than one legal system. The declaration may be made at any time, including before or after ratification, approval or accession (reference is made to a "State" and not to a "Contracting State", since a declaration may be made by a signatory State). The effect of a declaration under article 35 is that a party located in a territorial unit, to which the draft Convention is not to be applied by virtue of the declaration, is not considered to be located in a Contracting State (paragraph (3)). If that party is the assignor, the draft Convention would not apply at all. If that party is the debtor, the provisions of the draft Convention dealing with the rights and obligations of the debtor would not apply. The time when the debtor needs to be located in a Contracting State or when the law governing the assigned receivable needs to be the law of a Contracting State is not clear (article 1 (2)). Unless this time is specified in article 1 (2) (and possibly in article 35), if the debtor is located in a Contracting State at the time of the conclusion of the contract of assignment but, as a result of a declaration under article 35, not at the time a future receivable arises or at the time of notification, it would not be clear whether the draft Convention would apply in respect of such a debtor (for a Secretariat suggestion in favour of the time of the conclusion of the original contract, see para. 17).

Article 36. Conflicts with other international agreements

This Convention does not prevail over any international agreement which has already been or may be entered into and which contains provisions concerning the matters governed by this Convention[, provided that the assignor is located in a State party to such agreement or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in a State party to such agreement].

References

A/CN.9/445, paras. 52-55, 75, 76 and 201-203
A/CN.9/455, paras. 67-73 and 126-129
A/CN.9/456, paras. 232-239
A/CN.9/466, paras. 192-195

Commentary

203. Reflecting generally acceptable principles as to conflicts among international legislative texts (see, e.g., article 30 of the Vienna Convention on the Law of Treaties, 1969 ("the Vienna Convention"); and article 90 of the United Nations Sales Convention), article 36 gives precedence to other texts that contain provisions that deal with matters covered by the draft Convention. Texts with which the draft Convention may be in conflict include the Ottawa Convention, the Rome Convention, the Mexico City Convention, the Guarantee and Standby Convention, the draft European Union Insolvency Regulation and the preliminary draft Convention on International Interests in Mobile Equipment.

Ottawa Convention

204. The substantive and territorial scope of the Ottawa Convention is narrower than the scope of the draft Convention (transactions not covered include factoring contracts, in which only one of the three services mentioned in article 1 of the Ottawa Convention is offered; no notification is given; the assignor, the assignee or the debtor is not located in a Contracting State). In addition, parties may exclude the application of the Ottawa Convention as a whole. Moreover, the Ottawa Convention does not address certain issues (e.g., priority issues). However, to the extent that the two Conventions apply to a factoring contract, their application may lead to conflicting results in a number of respects (e.g., the scope of the reservation to the rule on contractual limitations to assignment, notification relating to receivables not existing at the time of notification, discharge of the debtor by payment to the assignee with knowledge of another person's superior right and recovery from the assignee of payments made by the debtor). In such instances, the question would arise whether the draft Convention as a whole was set aside or whether it could apply, at least, with respect to matters not addressed in the Ottawa Convention (e.g. priority issues). The matter is not explicitly addressed in article 36, although the argument could be made that, with respect to such issues there would be no conflict and the draft Convention would apply, if the requirements for its application were met. The Commission may wish to address this matter explicitly in article 36. As to matters covered in the draft Convention and in the Ottawa Convention, to the extent any conflicts would arise, the Ottawa Convention would prevail. However, in view of the fact that the Ottawa Convention also contains a provision along the lines of article 36, it may not be clear which of the two Conventions would apply in a particular case. If the result is that the Ottawa Convention applies, a different problem arises. If the two conventions apply to a particular factoring contract, the Ottawa Convention prevails and the parties to the factoring contract or to the contract from which the assigned receivables arise, exclude the application of the Ottawa Convention (article 3 of the Ottawa Convention), the draft Convention would not apply by virtue of article 36 and the Ottawa Convention would not apply as its application would have been excluded by the parties. In such a case, again it would not be clear which law applied.

205. There are different ways in which these matters could be addressed. One way would be to leave the matter to party autonomy. If parties exclude the application of the Ottawa Convention and opt into the draft Convention, the draft Convention should apply, at least, if all the conditions for its application that are set forth in chapter I are met (although, in some States, the draft Convention may apply by virtue of their private international law rules even if it would not be applicable in the absence of a choice by the parties). Such a choice of law would normally be effective, unless it ran contrary to the public policy or mandatory law of the forum. This result, however, would run counter to the policy underlying articles 24 to 26 and 30 of the draft Convention, which do not allow parties to choose the law applicable to priority issues. Another way would be to leave it to each State to decide which text it wishes to give precedence to (see, e.g., article 33 (2) in A/CN.9/WG.II/WP.104; see also article 20 of the Mexico City Convention; for critical remarks on this provision, see A/CN.9/466, paras. 192-195). Such an approach, however, could have a negative effect on certainty of law. Parties would need to examine each declaration and to determine its exact content, the connection with the location of the assignor or the debtor and the relevant time for the declaration to affect the interests of the assignor, the assignee and third-party creditors, on the one hand, and the interests of the debtor, on the other hand. Yet another way to address these matters would be to provide explicitly in article 36 that the draft Convention would apply to factoring contracts and issues not addressed in the Ottawa Convention. The possible disadvantage of such an approach is that, in order to determine whether the draft Convention would

apply to a particular factoring contract, parties would have to examine the Ottawa Convention. This result might complicate the application of the draft Convention and raise the cost of the transaction. A fourth way to address conflicts with the Ottawa Convention would be for the draft Convention to supersede the Ottawa Convention. Such an approach would raise a question of legislative policy that States would need to address. From a substantive point of view, however, such an approach seems to provide the highest possible degree of certainty. Language along the following lines could be considered for insertion in article 36:

Variant A

"(2) If this Convention is set aside by virtue of paragraph (1) of this article and the application of the Ottawa Convention is excluded by the parties to the factoring contract or to the original contract, such parties may opt into this Convention [if the conditions of chapter I are met]."

Variant B

"(2) A State may declare at any time that the Convention will not prevail over international conventions or other multilateral or bilateral agreements listed in the declaration, which it has entered or will enter into and which contain provisions concerning the matters governed by this Convention."

Variant C

"(2) If the Ottawa Convention does not apply or with respect to an issue not addressed in the Ottawa Convention, this Convention applies."

Variant D

"(2) Notwithstanding paragraph (1) of this article, this Convention supersedes the Ottawa Convention."

206. Variant A would be consistent with the principle of party autonomy. Variants B to D would be in line with article 30 (2) of the Vienna Convention, which allows for a treaty to specify which treaty prevails in the case of conflicts. If the Commission decides to retain the bracketed language in article 36, it would need to be supplemented by a reference to the application of the draft Convention with respect to the rights and obligations of the debtor in cases where the law governing the receivable is the law of a Contracting State (article 1 (2)).

Mexico City and Rome Conventions

207. There are no conflicts between the draft Convention and the Mexico City Convention, which addresses the law applicable to contracts in general (not assignment in particular) and in a way that is consistent with article 28 of the draft Convention. Any conflicts between article 12 of the Rome Convention and articles 28 and 29 of the draft Convention are minimal, since those articles are identical with article 12 of the Rome Convention (with the exception of the express choice required in article 28 (1) and the rebuttable presumption foreseen in article 28 (2)). Furthermore, normally, no conflicts should arise between article 12 of the Rome Convention and article 30 of the draft Convention, since, according to the prevailing view, article 12 of the Rome Convention does not address this matter. However, in the literature and in case law, the view has been expressed that article 12 of the Rome Convention addresses issues of priority, either in paragraph (1) (the law chosen by the parties) or in paragraph (2) (the law governing the receivable). The Working Group has taken the position that neither of those two laws is appropriate. In any case, in order to avoid any conflict with the Rome Convention, article 37 provides that a State may opt out of chapter V. As a result, if all States parties to

the Rome Convention opt out of chapter V, no conflict would arise. However, an opt-out of articles 24 to 26 is not allowed. Therefore, conflicts may arise between articles 24 to 26 of the draft Convention and article 12 of the Rome Convention. Neither article 36 nor its equivalent article 21 of the Rome Convention would sufficiently clarify which convention applies in the case of conflicts, since they both give way in favour of another text. As a result, uncertainty might prevail. The matter could be left to the principles of public international law, under which the more specific or the substantive law text (i.e. the draft Convention) would prevail. However, addressing the matter explicitly in article 36 would enhance certainty. The Commission may wish to consider leaving the matter to party autonomy or to each State, or allowing the draft Convention to supplement or supersede the Rome Convention (see the variants presented in para. 205).

208. The Commission may wish to consider whether article 36 should also address conflicts with supra-national law that is not in the form of an international agreement (e.g., EU regulations). Addressing the matter in article 36 and giving precedence to such supra-national law could remove a possible obstacle to some States adopting the draft Convention.

European Union draft Insolvency Regulation

209. No conflicts arise with the draft European Union Insolvency Regulation (approved by the Council of the Union and pending before the European Parliament). The notion of central administration is identical with the centre of main interests used in the draft Insolvency Regulation and that Regulation does not affect rights *in rem* in a main insolvency proceeding. While the draft Insolvency Regulation might affect rights *in rem* in a secondary insolvency proceeding (articles 2 (g), 4 and 28), article 25 would be sufficient to preserve, for example, super-priority rights and, in any case, the draft Convention should not affect special insolvency rights (see paras. 179-182).

Guarantee and Standby Convention

210. If the assignment of the right to demand payment of an independent undertaking is excluded from the draft Convention and the assignment of proceeds of such an undertaking is subject to article 5, no conflicts arise with the Guarantee and Standby Convention (see paras. 48 and 52).

Preliminary draft Convention on International Interests in Mobile Equipment

211. Conflicts may arise with the preliminary draft Convention on International Interests in Mobile Equipment, currently being prepared by a group of experts in the context of the International Civil Aviation Organization ("ICAO"), Unidroit and other organizations. This preliminary draft Convention is intended to apply to high-value mobile equipment, although it contains no definite list of types of equipment to be covered and in article 2 it refers to a "uniquely identifiable object". It does, however, require the preparation of a protocol for the draft Convention to apply to a particular type of equipment (article 7). The main characteristic of this preliminary draft Convention with respect to an assignment of receivables is that it treats the principal obligation, that is, the receivable arising from the sale or lease of mobile equipment, as an accessory right of the security right in mobile equipment. As a result, an assignee who registers its security right in the mobile equipment with the international equipment-specific register of the preliminary draft Convention would automatically obtain the principal obligation. An assignee of the principal obligation without a security right in the mobile equipment could not register or obtain priority. Under article 36, any conflicts with the preliminary draft Convention would be resolved in favour of the application of the preliminary draft Convention (a matter that may be further clarified in the preliminary draft Convention). The same result would be reached, even in the absence of article 36, since according to general principles of customary treaty law the more specific text prevails (*lex specialis derogat legi generali*).

Article 37. Application of chapter V

A State may declare at any time that it will not be bound by chapter V.

References

A/CN.9/455, paras. 72 and 148 A/CN.9/466, paras. 196 and 197

Commentary

212. In order to make the draft Convention more acceptable to States parties to existing private international law texts, such as the Rome Convention, article 37 allows States to opt out of chapter V. Such an opt-out is consistent with the decision of the Working Group that chapter V should form an integral part of the draft Convention. Unlike an opt-out, an opt-in could have the unintended effect of discouraging States from adopting chapter V.

Article 38. Limitations relating to Governments and other public entities

A State may declare at any time that it will not be bound by articles 11 and 12 if the debtor or any person granting a personal or property right securing payment of the assigned receivable is located in that State at the time of the conclusion of the original contract and is a Government, central or local, any subdivision thereof, or any public entity. If a State has made such a declaration, articles 11 and 12 do not affect the rights and obligations of that debtor or person.

References

A/CN.9/432, para. 117 A/CN.9/456, paras. 115 and 116
A/CN.9/455, para. 48 A/CN.9/466, paras. 107-115

Commentary

213. Article 38 is intended to ensure that sovereign debtors are not affected by assignments made in violation of contractual limitations on assignment contained in public procurement or other similar contracts. As a result of article 38, an assignment of receivables owed by a sovereign debtor located in a State that has made a declaration at the time of the conclusion of the original contract is not effective as against the sovereign debtor. However, the assignment remains effective as against the assignor and the assignor's creditors. The Working Group decided to take this approach so as to avoid reducing the acceptability of the draft Convention to States that may not be able to protect sovereign debtors by way of a statutory limitation. The Working Group recognized that most States would protect sovereign debtors by way of a statutory limitation, which the draft Convention would not affect. It was also widely felt that a substantive rule giving full effect to a contractual limitation and invalidating the assignment as against a sovereign debtor, would raise the cost of credit for sovereign debtors irrespective of whether they wished or needed to be protected in such a way. Furthermore, the Working Group recognized that, once the sovereign debtor was protected, there was no reason to invalidate the assignment in general. Preserving the validity of the assignment as between the assignor and the assignee would allow the assignee to obtain priority by meeting the requirements of the law of the assignor's location.

214. Unlike article 6 of the Ottawa Convention, which allows a reservation with regard to any debtor, article 38 allows a reservation only with respect to sovereign debtors. In taking this approach, the Working Group was of the view that States considering the adoption of the draft Convention would need to weigh the potential inconvenience to the debtor of having to pay a different person against the advantage of increased availability

of lower-cost credit to debtors and assignors, which could stimulate the economy at large. Article 38 is intended to allow a State to exclude the application of articles 11 and 12 in the case of any entity of the central or local Government or any subdivision thereof. As to public entities, article 38 leaves a wide flexibility to States to determine the types of entities they wish to exclude from the application of articles 11 and 12 (without limiting the application of article 38 to publicly owned commercial entities or to governmental authorities acting in a commercial capacity). The Working Group recognized that it was the prerogative of each State to determine which type of public entity it wished to protect. Such an approach is particularly necessary in those countries in which government entities and their activities are not governed by a special body of public law but are subject to the rules governing "commercial" entities and activities.

[*Article 39. Other exclusions*

A State may declare at any time that it will not apply the Convention to specific practices listed in a declaration. In such a case, the Convention does not apply to such practices if the assignor is located in such a State or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in such a State.]

References

A/CN.9/466, paras. 198-201

Commentary

215. With a view to making the draft Convention more acceptable to States that might be concerned with its application to certain practices, article 39 provides the possibility for States to exclude further practices. Article 39 appears within square brackets pending final determination of the exact scope of the draft Convention. Once the scope of the draft Convention and, in particular, article 5 is finalized, the Commission may wish to consider whether article 39 would be necessary. If article 39 is retained, reference would have to be included in the second sentence to the law governing the receivable and to the time of the original contract at which the debtor would need to be located in a Contracting State or the law governing the assigned receivable would need to be the law of a Contracting State (article 1 (2); see also para. 17). As a substitute for the second sentence of article 39, a new second paragraph could be considered along the following lines:

"(2) If a State makes a declaration under paragraph (1) of this article:

"(a) The Convention does not apply to such practices if the assignor is located at the time of the conclusion of the contract of assignment in such a State; and

"(b) The provisions of the Convention that affect the rights and obligations of the debtor do not apply if, at the time of the conclusion of the original contract, the debtor is located in such a State or the law governing the receivable is the law of such a State."

Article 40. Application of the annex

(1) A Contracting State may at any time declare that

Variant A

it will be bound either by sections I and/or II or by section III of the annex to this Convention.

Variant B

it:

(a) Will be bound by the priority rules based on registration set out in section I of the annex and will participate in the international registration system established pursuant to section II of the annex;

(b) Will be bound by the priority rules based on registration set out in section I of the annex and will effectuate such rules by use of a registration system that fulfils the purposes of such rules [as set forth in regulations promulgated pursuant to section II of the annex], in which case, for the purposes of section I of the annex, registration pursuant to such a system shall have the same effect as registration pursuant to section II of the annex; or

(c) Will be bound by the priority rules based on the time of the contract of assignment set out in section III of the annex.

(2) For the purposes of article 24, the law of a Contracting State that has made a declaration pursuant to paragraph (1) (a) or (b) of this article is the set of rules set forth in section I of the annex, and the law of a Contracting State that has made a declaration pursuant to paragraph (1) (c) of this article is the set of rules set forth in section III of the annex. The Contracting State may establish rules pursuant to which assignments made before the declaration takes effect shall, within a reasonable time, become subject to those rules.

(3) A Contracting State that has not made a declaration pursuant to paragraph (1) of this article may, pursuant to its domestic priority rules, utilize the registration system established pursuant to section II of the annex.

References

A/CN.9/455, paras. 122 and 130-132 A/CN.9/466, paras. 188-191, 202 and 203

Commentary

216. Article 40 is intended to list the choices available to States with regard to the annex and the effects of any such choice made by way of a declaration (permitted under article 1 (4); see para. 23). It contains two alternatives. Variant A briefly presents the choices available to States, without addressing their effects (its content and formulation and, in particular, the words “and/or” have not been approved by the Working Group). Variant B is a more elaborate version of variant A and sets forth the various choices and their effects. Under variant B, States would have four alternative choices with regard to the annex, namely, to adopt the priority rules of section I and the registration system proposed in section II (paragraph (1) (a)); to adopt the priority rules of section I and a registration system other than that proposed in section II (paragraph (1) (b)); to adopt the priority rules of section III (paragraph (1) (c)); or to adopt the registration system of section II and priority rules other than those set forth in section I (paragraph (3)). The difference between the choices in paragraph (1) and the choice in paragraph (3) is that, a State would not need to make a declaration to exercise the choice given in paragraph (3) of the second alternative. Under paragraph (2) of variant B, depending on which section of the annex a State has opted into, section I or section III of the annex is the law of the assignor’s location,

provided that the State that has made the declaration is the State of the assignor's location at the time of the conclusion of the contract of assignment (a matter that would need to be stated explicitly in article 40). In line with articles 35 to 39 and 41, article 40 should refer to a State (not a Contracting State), since a declaration may be made "at any time", including at the time of signature but before ratification, acceptance or approval.

Article 41. Effect of declaration

(1) Declarations made under articles 35 (1) and 37 to 40 at the time of signature are subject to confirmation upon ratification, acceptance or approval.

(2) Declarations and confirmations of declarations are to be in writing and to be formally notified to the depositary.

(3) A declaration takes effect simultaneously with the entry into force of this Convention in respect of the State concerned. However, a declaration of which the depositary receives formal notification after such entry into force takes effect on the first day of the month following the expiration of six months after the date of its receipt by the depositary.

(4) Any State which makes a declaration under articles 35 (1) and 37 to 40 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification of the depositary.

[(5) A declaration or its withdrawal does not affect the rights of parties arising from assignments made before the date on which the declaration or its withdrawal takes effect.]

References

A/CN.9/445, paras. 79 and 80
A/CN.9/455, paras. 145 and 146
A/CN.9/466, para. 206

Commentary

217. Paragraphs (1) to (4) reflect standard treaty law practice. Under paragraphs (1) and (2), declarations made at the time of signature must be confirmed at the time of ratification, approval or accession; and declarations and confirmations must be in writing and formally notified to the depositary. Under paragraph (3), a declaration takes effect at the same time the Convention enters into force in respect of the State making the declaration. There is a six-month delay if the depositary is notified of the declaration after the entry into force. The six-month period starts at the time of receipt of the formal notification by the depositary and ends on the first day after the expiry of the six-month period. Under paragraph (4), withdrawals of declarations take effect on the first day after the expiry of six months after the receipt of the formal notification by the depositary.

218. Paragraph (5) deals with an issue relating to the transitional application of the draft Convention. Like the transitional application rules in articles 43 (3) and 44 (3), it appears within square brackets, since the Working Group decided to leave this matter to the Commission (see A/CN.9/466, para. 206). Issues relating to the transitional application of the draft Convention are made more complex by the fact that an assignment may affect the interests of more than the parties thereto and different points of time may need to be taken into account for the protection of the various parties. Paragraph (5) is intended to ensure that, if a State makes or withdraws a declaration under article 35, 37, 38, 39 or 40, the declaration or withdrawal does not affect rights acquired before the declaration or its withdrawal takes effect.

219. Paragraph (5) would need to refer also to obligations and to specify the effect on all parties, assignors, assignees and debtors. Like article 39, paragraph (5) would also need to clarify whose rights and obligations are affected, depending on whose State makes or withdraws a declaration and when. A declaration or its withdrawal made by the State in which the assignor is located at the time of the conclusion of the contract of assignment should not be allowed to affect the rights and obligations of the debtor. A declaration made by the State in which the debtor is located or whose law governs the receivable (at the time of the conclusion of the original contract; see articles 1 (2) and 35, as well as paras. 17 and 202) should not affect the priority among competing claimants. Only a declaration or its withdrawal made by the State or States in which the assignor and the debtor are located could affect the rights and obligations of all parties (this is practically possible only if the assignor and the debtor are located in the same State or at the initial entry into force of the draft Convention when it enters into force at the same time for all five Contracting States (articles 41 (3) and 43 (1)). Paragraph (5) may also need to deal with the issue of assignments of receivables arising after a declaration or its withdrawal takes effect but before the debtor receives notification of the assignment. It would appear that, in such a case, the declaration or its withdrawal could be allowed to affect the debtor's rights and obligations. Such a result would not frustrate any legitimate expectations of the debtor relating to the application of the draft Convention, since before notification is received the debtor does not know whether the draft Convention would apply and, therefore, cannot have expectations as to the exact effect of the draft Convention on its rights and obligations.

Article 42. Reservations

No reservations are permitted except those expressly authorized in this Convention.

References

A/CN.9/455, paras. 147 and 148

Commentary

220. Article 42, which reflects standard treaty law practice, is intended to ensure that no reservation is made other than those expressly authorized in articles 35 (1) and 37 to 40.

Article 43. Entry into force

(1) This Convention enters into force on the first day of the month following the expiration of six months from the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession.

(2) For each State which becomes a Contracting State to this Convention after the date of the deposit of the fifth instrument of ratification, acceptance, approval or accession, this Convention enters into force on the first day of the month following the expiration of six months after the date of the deposit of the appropriate instrument on behalf of that State.

[(3) This Convention applies only to assignments made on or after the date when the Convention enters into force in respect of the Contracting State referred to in article 1 (1).]

References

A/CN.9/455, paras. 149 and 150 A/CN.9/466, para. 206

Commentary

221. Paragraphs (1) and (2) reflect standard treaty law practice. In determining that six months and five ratifications are required for the draft Convention to enter into force, the Working Group took into account the need for the draft Convention to enter into force as soon as possible, provided that it has received support from a sufficient number of States. Paragraph (3) is intended to ensure that rights acquired before the entry into force are not affected by the draft Convention. Like articles 41 (5) and 44 (3), it appears within square brackets, since the Working Group decided to leave to the Commission issues relating to the transitional application of the draft Convention (see A/CN.9/466, para. 206).

Article 44. Denunciation

(1) A Contracting State may denounce this Convention at any time by means of a notification in writing addressed to the depositary.

(2) The denunciation takes effect on the first day of the month following the expiration of one year after the notification is received by the depositary. Where a longer period is specified in the notification, the denunciation takes effect upon the expiration of such longer period after the notification is received by the depositary.

[(3) The Convention remains applicable to assignments made before the date on which the denunciation takes effect.]

References

A/CN.9/455, paras. 151-155 A/CN.9/466, para. 206

Commentary

222. Article 44 is intended to ensure that a Contracting State may denounce the draft Convention. The second sentence of paragraph (2) may not be necessary. If a State wishes to prolong the time for the denunciation to take effect, it may postpone notifying the depositary. Allowing States to vary the time at which denunciations take effect may result in uncertainty as to the application of the draft Convention or, at least, to raising the cost of transactions, to the extent that parties would need to check declarations made by States so as to determine the time when the denunciation takes effect. Furthermore, such an approach would be inconsistent with article 41 (3), which does not allow States to vary the time at which a declaration takes effect. With a view to ensuring certainty, paragraph (3) provides that a denunciation does not affect rights acquired before it takes effect. Such an approach is particularly necessary to protect rights of third parties, who might have extended credit against future receivables, while relying on the application of the draft Convention. Without such a uniform rule, third parties would need to rely on substantive rules on supervening changes of law provided under various legal systems, which might provide conflicting or unsatisfactory solutions for the situations under consideration. Such a result would be inconsistent with the main objective of the draft Convention to facilitate access to lower-cost credit.

Additional final provisions

223. The Commission may wish to consider including in the final provisions the following provision, which the Working Group, at its thirty-first session, did not have sufficient time to discuss (see A/CN.9/466, paras. 207 and 208):

"*Article X. Revision and amendment*

"1. At the request of not less than one third of the Contracting States to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

"2. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended."

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References

A/CN.9/420, paras. 155-164
A/CN.9/434, paras. 239-258
A/CN.9/445, paras. 18-44 and 83-93
A/CN.9/455, paras. 18-32 and 120-123

Commentary

224. In view of the fact that the Working Group was not able to reach agreement on a substantive law priority rule, articles 24 to 26 refer priority issues to national law (the law of the assignor's location). However, national priority rules may not exist, be outdated or not fully adequate in addressing all relevant problems. For that reason, the Working Group decided to include in an optional annex to the draft Convention two alternative substantive law priority rules, one based on the time of assignment and another based on registration. In order to determine whether their priority rules need revision, States may wish to compare them with the rules set forth in the annex.

225. While the rules set forth in the annex are intended to serve as a model for national legislation, they do not form a complete model law (and their application is limited to receivables). States would, therefore, need to prepare additional provisions. For example, if a registration-based system is chosen, some practices may need to be excluded from a registration-based priority regime and subjected to a different priority regime; and the registration rules would need to be supplemented by appropriate regulations. In general, the annex may apply only in a State that has made a declaration under article 40 (article 1 (4); see para. 23). The choices available to States and their effects are set forth in article 40 (see para. 216).

Section I. Priority rules based on registration

Article 1. Priority among several assignees

As between assignees of the same receivable from the same assignor, priority is determined by the order in which data about the assignment are registered under section II of this annex, regardless of the time of transfer of the receivable. If no such data are registered, priority is determined on the basis of the time of the assignment.

References

A/CN.9/445, paras. 88-90
A/CN.9/466, paras. 167 and 168

Commentary

226. The registration system envisaged in article 1 involves the voluntary entering of certain data about an assignment in the public record. The purpose of such registration is not to create or constitute evidence of property rights, but to protect third parties by putting them on notice about assignments made and to provide a basis for settling conflicts of priority between competing, equally effective claims. Because of its limited function and for it to be simple, quick and inexpensive, the registration envisaged in article 1 requires a very limited amount of data (specified in article 4 of the annex) to be placed on public record. If no data are filed, the first-in-time assignee prevails.

227. The policy underlying article 1 (and sections I and II) is that giving potential financiers notice about assignments and determining priority in receivables on the basis of a public filing system will enhance certainty as to the rights of financiers and, as a result, have a beneficial impact on the availability and the cost of credit on the basis of receivables. In order to ensure that the priority rules in section I operate with an existing national registration system, article 1 (which refers to a system under section II that would need to be established under article 3 of the annex) may need to be revised.

Article 2. Priority between the assignee and the insolvency administrator or the creditors of the assignor

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned, and data about the assignment were registered under section II of this annex, before the commencement of the insolvency proceeding or attachment.

References

A/CN.9/466, paras. 169 and 170

Commentary

228. Article 2 is intended to reflect the principle that, if registration takes place before the commencement of an insolvency proceeding with regard to the assets and affairs of the assignor or before attachment of the receivables in the hands of the assignor, the assignee has priority. As a result, the assignee may receive payment before unsecured creditors (special preferential rights existing under insolvency law, however, are not affected, see para. 182) . Furthermore, with a view to preserving any super-priority rights (e.g. claims of the State for taxes, of employees for wages or of the insolvency administrator for the costs of insolvency), the application of article 2 is made subject to article 25.

Section II. Registration

Article 3. Establishment of a registration system

A registration system will be established for the registration of data about assignments under this Convention and the regulations to be promulgated by the registrar and the supervising authority. The regulations will prescribe in detail the manner in which the registration system will operate, as well as the procedure for resolving disputes relating to that operation.

References

A/CN.9/445, paras. 94-103 A/CN.9/466, paras. 171 and 172

Commentary

229. The policy underlying article 3 is that, while the annex should include some basic provisions about registration, the mechanics of the registration process should be left to regulations to be prepared by the registrar and the supervising authority. In order to avoid creating the impression that the regulations might need to be more detailed than is practically necessary and to give sufficient flexibility to the registrar and the supervising authority in preparing the regulations, article 3 refers to the regulations prescribing "in detail" (but not "exactly") the operation of the registration system.

230. The registrar (who may, presumably, be a private entity) and the supervising authority (which is intended to be an intergovernmental organization) would have significant powers in settling, in addition to the mechanics of registration, substantial issues, such as court jurisdiction over, duties, liability, privileges and immunities of, the registrar. The Commission may, therefore, wish to consider ways in which the appointment of a supervising authority and a registrar should be effected. As the registrar and the supervising authority would be given wide powers with regard to the implementation of the draft Convention, it would seem that a process similar to the revision process involving a conference of Contracting States would be appropriate (see A/CN.9/466, paras. 165 and 166). Alternatively, the Commission may wish to identify in the annex an international, intergovernmental organization as the supervising authority and, possibly, the first registrar; and to deal in the annex with certain key issues, such as court jurisdiction over, duties and liability, as well as privileges and immunities of, the registrar and costs for establishing and operating the system (this is the approach followed in the ICAO/Unidroit preliminary draft Convention on International Interests in Mobile Equipment and in the preliminary draft Aircraft Protocol; see articles XVI and XIX of the preliminary draft Aircraft Protocol and articles 26, 26*bis* and 40 of the preliminary draft Convention).

Article 4. Registration

(1) Any person authorized by the regulations may register data with regard to an assignment at the registry in accordance with this Convention and the registration regulations. The data registered shall be identification of the assignor and the assignee, as provided in the regulations, and a brief description of the assigned receivables.

(2) A single registration may cover:

(a) The assignment by the assignor to the assignee of more than one receivable;

(b) An assignment not yet made;

(c) The assignment of receivables not existing at the time of registration.

(3) Registration, or its amendment, is effective from the time that the data referred to in paragraph (1) are available to searchers. The registering party may specify, from options provided in the regulations, a period of effectiveness for the registration. In the absence of such a specification, a registration is effective for a period of five years. Regulations will specify the manner in which registration may be renewed, amended or discharged and, consistent with this annex, such other matters as are necessary for the operation of the registration system.

(4) Any defect, irregularity, omission or error with regard to the identification of the assignor that would result in data registered not being found upon a search based on the identification of the assignor renders the registration ineffective.

References

A/CN.9/445, paras. 104-117 A/CN.9/466, paras. 173-178

Commentary

231. The purpose of article 4 is to establish the basic parameters for an efficient registration system. Those basic parameters include the public character of the registry, the type of data that need to be registered, the ways in which the registration-related needs of modern financing practices may be accommodated and the time of effectiveness of registration. The registry envisaged is a public registry. However, in order to avoid any abuses, some limitations may have to be introduced as to the persons who may register (e.g. only persons with a legitimate interest or with the authorization of the assignor) and the assignor may need to be given the right to demand deregistration. Paragraph (1) leaves those issues to the regulations. The regulations could also deal with abusive and fraudulent registration, although this matter should normally not pose a problem, since registration under article 4 does not create any substantive rights. In any case, the issue of any loss caused as a result of an unauthorized or fraudulent registration could be addressed by general tort, fraud or even criminal law rules. The data to be registered, under paragraph (1), include identification of the assignor and the assignee and a brief description of the assigned receivables. The type of identification required is left to the regulations. It is meant to include, however, identification by number. The words “brief description” are intended to include a generic description, such as “all my receivables from my car business” or “all my receivables from countries A, B and C”. Paragraph (2) is a key provision in that it is intended to ensure the efficient operation of the registration system and to accommodate the needs of significant transactions. Under subparagraphs (a) and (c), a single notice could cover a large number of receivables, existing or future, arising from one or several contracts, as well as a changing body of receivables and a constantly changing amount of secured credit (revolving credit). Without these features, registration would be expensive, slow and inefficient. Any abuse, which could harm the assignor without, however, creating substantive rights, is left to other legislation.

232. Under paragraph (3), registration is effective when searchers obtain access to the data registered. This means that, if the assignor becomes insolvent after registration but before the data become available to searchers, the risk of any events that may affect the interests of the registering party is placed on that party. With the exception of cases involving the restructuring of troubled credits, in which prompt disbursement of funds is essential, the registering party may protect itself by withholding disbursements until registered data become available. Such a risk would be significantly reduced if there was no time gap between data being registered and becoming available to searchers, which is possible in the case of electronic registration systems. Paragraph (3) permits registering parties to choose the length of time of effectiveness from a range of options set out in the regulations. In the absence of a choice, the time of effectiveness is five years. Renewals, discharges and amendments, as well any other matter necessary for the operation of the registry, are left to the regulations. With a view to preserving registrations with minor errors, paragraph (4) invalidates a registration only if there is a defect, irregularity or omission in the identification of the assignor that would preclude

searchers from finding the data registered. The underlying rationale is that: if the error is made by the registering party, that party should suffer the consequences; and if the error is committed by the registrar, the registrar should be held liable (an issue to be addressed in the regulations). The words "would result" are intended to ensure that the registration would be ineffective, in the case of a significant error in the identification of the assignor, even if no one was actually misled. Minor errors or omissions in the identification of the assignor, or any errors or omissions in the identification of the assignee or the description of the assigned receivables, do not render the registration ineffective.

Article 5. Registry searches

(1) Any person may search the records of the registry according to identification of the assignor, as provided in the regulations, and obtain a search result in writing.

(2) A search result in writing that purports to be issued from the registry is admissible as evidence and is, in the absence of evidence to the contrary, proof of the data to which the search relates, including:

(a) The date and time of registration; and

(b) The order of registration.

References

A/CN.9/445, paras. 118 and 119 A/CN.9/466, paras.179 and 180

Commentary

233. Article 5 is intended to enshrine the principle of public access to the registry for searching purposes as opposed to registration purposes. Only a publicly accessible registry could provide the transparency necessary to enhance certainty with regard to the rights of third parties. Such public access to the registry does not infringe upon the confidentiality necessary in financing transactions, since only a limited amount of data would be available in the registry. Article 5 also provides for the admissibility and the general evidential value of a search record in a court or other tribunal. A search record is, in particular, evidence of the data necessary to establish priority, that is, the date and the time of registration and the order of registration.

Section III. Priority rules based on the time of the contract of assignment

Article 6. Priority among several assignees

As between assignees of the same receivable from the same assignor, the right to the receivable is acquired by the assignee whose contract of assignment is of the earliest date.

References

A/CN.9/445, paras. 83-87 A/CN.9/466, paras. 181-185

Commentary

234. Under article 6, the first-in-time assignee acquires the assigned receivable. Any subsequent assignee obtains nothing, since the assignor has nothing more to transfer (*nemo dat quod non habet*). If there cannot be more than one effective assignment of the same receivables by the same assignor, no conflict of priority can arise as between several assignees of those receivables. In addition, article 6 may not address a priority conflict as between several assignees, if the assignor assigns different parts of the same receivables to different assignees, since, assuming that national legislation allows the assignment of parts of receivables, different "receivables" would be involved. Moreover, article 6 would not address a conflict of priority between several assignees, if the same receivables are assigned by the assignor to different assignees to secure different amounts of credit not exceeding the value of the receivable. If that is the intended meaning of article 6, the title of section III and article 6, which refer to "priority", would need to be revised. If, under article 6, more than one assignment of the same receivables may be effective, article 6 would need to be revised, for example, along the following lines: "As between assignees of the same receivable from the same assignor, priority is determined on the basis of the time of assignment". In its deliberations, the Commission may wish to consider the priority system introduced by draft articles 12.401 of the European Contract Principles. Under that article, priority is to be determined on the basis of time of notification of the debtor and, in the absence of a notification, on the basis of the time of assignment. In either case, the requirements of the law applicable to insolvency have to be met.

Article 7. Priority between the assignee and the insolvency administrator or the creditors of the assignor

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned before the commencement of the insolvency proceeding or attachment.

References

A/CN.9/445, paras. 83-87 A/CN.9/466, paras. 186 and 187

Commentary

235. Unlike article 6 of the annex, article 7 refers to priority. However, if the receivable is effectively transferred before commencement of an insolvency proceeding or attachment, at least in the case of an outright assignment, no issue of priority arises (the receivable is not part of the insolvency estate). Such a priority issue may arise in the case of an assignment by way of security, where the assignee would seek to be paid first out of the proceeds of the receivable. Depending on the correct understanding of article 7, the Commission may wish to revise it. As in article 2 of the annex priority is not intended to affect special insolvency rights (see para. 182); and the opening words are intended to preserve super-priority rights under the law of the forum State (see para.181).

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