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Possible future coordination and technical assistance work on security interests and related topics

Note by the Secretariat

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I. Introduction

1. This document contains a summary of the considerations and conclusions reached at the Colloquium with respect to possible future coordination and technical assistance work on security interests and related topics.

II. Possible future coordination and technical assistance work topics

A. The law applicable to proprietary effects of assignments of receivables

1. Continued divergence in national law approaches

2. The panel that dealt with the law applicable to proprietary effects of assignments of receivables agreed that national disharmony in the conflict-of-law rules for determining the law applicable to the assignment of receivables is a long-standing problem in private international law. That said, a multilateral consensus appears to have been reached on the following three issues. First, the applicable law should be the same for both the outright assignment of and the grant of security in receivables. Second, relations between the assignor and assignee should be governed by the law applicable to the contract of assignment. Third, relations between the assignee and the debtor of the receivable should be governed by the law applicable to the assigned receivable (meaning the law applicable to the contract giving rise to the receivable in the case of contract-generated receivables). The consensus on these three issues is reflected: (a) at the international level, in the United Nations Convention on the Assignment of Receivables in International Trade (the "Assignment Convention"), the Secured Transactions Guide and the Model Law; and (b) in the European Union, in article 14 of the Rome I Regulation (Regulation (EC) 593/2008 on the law applicable to contractual obligations).

3. Where consensus remains elusive is with respect to the appropriate connecting factor for determining the law applicable to the proprietary effects of an assignment of receivables against third parties, and the priority of the assignee's right against competing claimants (including the assignor's insolvency administrator). As a result of the uncertainty with respect to the law applicable to these matters, credit on the basis of receivables is less available or is available at a higher cost.

4. Under the UNCITRAL instruments referred to above, the law of the State in which the assignor is located (place of business and, in the case of places of business in more than one State, the centre of main interests) applies as a general rule (subject to exclusions and exceptions for certain types of receivables, notably financial receivables arising from bank accounts, securities, financial market and derivatives transactions, and transactions on regulated exchanges and clearing and settlement systems).

5. As reflected in the panel presentations, however, national laws continue to diverge on this issue. For example, under the statutory conflict-of-laws rules in effect in the territorial units that make up the United States of America and Canada (including in the case of Canada, the civil law province of Quebec), the law of the assignor's location generally applies in both the intrastate and international conflict-of-laws contexts. While this solution is in line with the UNCITRAL approach, Japan's private international law statute, enacted in 2006, refers the effects of an assignment against both the debtor and third parties to the law applicable to the assigned receivable.

2. Current status of the matter in the European Union

6. As explained in the panel presentations, the member States of the European Union have also yet to agree on a uniform solution. In 2005, the European

Commission proposed adoption of the law of the assignor's habitual residence in line with the UNCITRAL approach (habitual residence was defined to be close to the place of business and the place of central administration) and the views of the majority of respondents to the European Commission's 2003 Green Paper. It was ultimately decided, however, that the issue required further study and the proposed rule was omitted from the 2008 Rome I Regulation. Instead, article 27(2) required the European Commission to submit a report on the issue, accompanied by a proposal for a potential future European solution. The European Commission engaged the British Institute of International and Comparative Law (BIICL) to carry out a study (published in 2011) and submitted its report in 2016. Based on the BIICL study, the European Commission report confirmed the need for a uniform European legislative solution.

7. Importantly, the European Commission report also emphasized the need for a future proposal to also address the existing disharmony on the conflict-of-laws rules applicable to cross-border transactions in securities. Existing European Union directives have harmonized these rules only to a limited extent and have been transposed into national law in divergent ways. There are also divergent views on whether certain types of intangible assets are more appropriately characterized as securities or receivables.

8. To ensure coordination, the Capital Markets Union (CMU) Action Plan (2015) and CMU Communication (2016) envisages a dedicated legislative proposal from the European Commission on the law applicable to the ownership of securities and the third-party effects of the assignment of receivables. To this end, an inception impact assessment was published in 28 February 2017, to be followed by a detailed online public consultation with stakeholders to be launched in the first quarter of 2017 (the public consultation was in fact launched on 7 April 2017 with a deadline of 30 June for receiving responses). It is also planned to set up an advisory expert group composed of experts on private international law and finance markets. A stakeholders' meeting to discuss the results of the public consultation is envisaged for early September 2017, followed by publication of an impact assessment of the ultimate proposal in mid-September 2017. Adoption of a proposal by the European Commission is anticipated by December 2017.

3. Possible future solutions in the European Union

9. While confirming the demand for a uniform rule on the law applicable to the third-party effects and the priority of the assignee's rights, the panel noted that the 2011 BIICL study reported divergent sectoral, expert and Member State views as to which law should apply. Based on the alternative drafting proposals set out in the BIICL study (with minor modifications), the 2016 Commission Report presented three possible solutions: (a) the law applicable to the contract between the assignor and the assignee; (b) the law applicable to the assigned receivable; and (c) the law of the assignor's habitual residence (i.e. the UNCITRAL approach). The advantages and disadvantages of each of these possibilities was addressed in the BIICL study and the European Commission report and discussed by the various panel participants.

Law of the assignor's location (the UNCITRAL approach)

10. The principal advantages of this solution are seen to be: (a) facilitation of bulk assignments insofar as a single law applies to an assignment of receivables owed by multiple debtors in multiple States; (b) facilitation of assignments of receivables arising under future contracts insofar as the applicable law can be determined ex ante when the assignment is made; (c) increased legal certainty and predictability insofar as the applicable law can be easily ascertained by both assignees and third parties including the assignor's creditors; and (d) coincidence of the applicable law with the insolvency law in the event of the assignor's insolvency, thereby minimizing potential conflicts and the need to demarcate whether an issue relates to insolvency law or to the proprietary effects of the assignment on third parties.

11. The principal disadvantages are seen to be: (a) separation of the law applicable to the effects of the assignment as against the debtor and as against third parties, raising characterization and demarcation challenges; (b) the potential for multiple laws to apply in the event of: (i) a change in the assignor's location over time with the result that a different law may apply in a priority competition with a subsequent assignee or other competing claimant; (ii) subsequent assignments by the original assignee if the subsequent assignee is located in a different State than the original assignee; and (iii) the assignment of an unseverable debt owed jointly to multiple assignors located in different states; and (c) the potential unsuitability of this approach to certain types of financial claims and instruments.

12. To mitigate certain of these disadvantages, the European Commission report and BIICL study suggest: (a) questions of third-party effectiveness and priority in the event of a change in the location of the assignor over time could be resolved by referring to the law of the State in which the assignor is located as of the date of the last assignment or other event giving rise to a competing right; and (b) the perceived incompatibility of this approach for financial claims could be addressed by a limited exception, pointing to the law governing the assigned receivable (or to some other appropriate law depending on the particular type of receivable).[1] While such an exception is compatible with the exclusions and exceptions in the Assignment Convention and other UNCITRAL instruments, it was noted that demarcating the exceptional group of receivables that should be subject to a special rule would be challenging.

Law applicable to the assigned receivable

13. The principal advantages of this solution are seen to be: (a) the same law applies to the effects of the assignment against the debtor and third parties, thereby avoiding the need to delineate whether an issue is an assignee-debtor issue or an assignee-third-party issue; (b) enhanced stability of the applicable law both because the law governing the assigned receivable is unlikely to change over time and because the same law would normally also govern subsequent assignments by the original assignee to a new assignee.

14. The principal disadvantages are seen to be: (a) this solution does not permit a determination of the law applicable to an assignment of future receivables arising under contracts that have not yet been concluded; (b) increased complexity and costs in the case of a bulk assignment of receivables owed by debtors in multiple States insofar as the third-party effectiveness and priority of the assignee's right in the same portfolio of receivables could potentially be subject to multiple applicable laws; (c) the law applicable to the assigned receivable may not always be easy to identify if there is no clear choice of law in the contract between the debtor and assignor or if the receivable assigned is not contractual; (d) risk of prejudice to third parties insofar as: (i) the parties to the assigned receivable can choose the law applicable to it, and could change the applicable law; (ii) there is a lack of transparency with respect to the applicable law for third parties, notably the assignor's creditors, who ordinarily would not have access to the contract giving rise to the receivable in order to determine the applicable law; and (e) uncertainty and demarcation challenges in the event of the assignor's insolvency to the extent the *lex concursus* does not coincide with the law applicable to the assigned receivable.

15. To address the unsuitability of this solution for assignments of receivables under future contracts, the BIICL study and the European Commission report suggest: (a) a specific exception pointing to the law of the assignor's habitual residence; and (b) resolving potential conflicts between different applicable laws in a priority dispute between competing assignees or between an assignee and another right holder by applying the law of the state in which the assignor is located as of the date of the last assignment or other event giving rise to a competing right.

[1] Article 91 of the Model Law addresses this issue.

Law of the contract between the assignor and the assignee

16. The principal advantages of this solution are seen to be: (a) flexibility for commercial actors to choose the law which best suits their needs; and (b) potential for the application of a single governing law for bulk assignments and assignments of future receivables.

17. The principal disadvantages are seen to be: (a) potential for abuse of third parties including the avoidance of mandatory registration or other publicity requirements; (b) lack of transparency of the applicable law for third parties, notably creditors who may not have access to the assignment contract to determine the applicable law; (c) potential for different laws to apply to the effects of the assignment against the debtor and against third parties (unless the law applicable to the receivable is the chosen law); (d) uncertainty and demarcation challenges in the event of the assignor's insolvency to the extent the *lex concursus* does not coincide with the chosen law; (e) potential for different conflicting laws to apply to priority in the event of successive assignments of the same receivable to different assignees; and (f) potential instability of the applicable law in the event of a change in the applicable law by the parties.

18. To mitigate the risk of prejudice to third parties, it was noted that the BIICL study and the European Commission report suggest that the available choices be limited to the law of the assigned receivable or the law of the assignor's location. To address the absence of a clear choice of law in the assignment contract, or if the chosen law does not correspond to the permitted choices, the Commission report suggests that the third-party effectiveness and priority of the assignee's right could be governed by the law of the assignor's location. To address the problem of competing assignments governed by different laws, the BICCL study and the European Commission report suggest that the general first-in-time property principle could apply, subject to the sequential application of the rules protecting bona fide acquirers of the law applicable to the second and any later assignments.

4. Conclusions

19. As the panel presentations revealed, while there is a strong demand for a uniform solution, the possible approaches summarized above all have their respective advantages and disadvantages and all pose problems of delineation insofar as they all contain exceptions and qualifications. It remains an open question whether the European Commission will ultimately propose any of these possible solutions or some other combination of approaches. For what it may be worth, it is noted that in the open discussion that followed the panel presentations, Colloquium participants focussed their remarks on the suitability of the UNCITRAL assignor location approach as a general rule including for securitization transactions.

20. As already noted (see para. 8 above), a dedicated legislative proposal from the European Commission on the law applicable to the ownership of securities and the third-party effects of the assignment of receivables is anticipated by the end of 2017. The Commission may wish to renew the mandate given to the secretariat to coordinate and cooperate with the European Commission and contribute to the stakeholder consultations and meetings leading up to the proposal with a view to avoiding any conflict with the Assignment Convention. Given that the pending proposal will also cover the conflict-of-law rules applicable to rights in securities and financial claims, the Commission may also wish to consider extending the mandate given to the secretariat to seek to avert any incompatibility with the conflict-of-laws rules of the Model Law, notably the rules determining the law applicable to security rights in non-intermediated securities, instruments, and bank accounts.

B. Technical assistance in secured transactions law reform: coordination and cooperation with other organizations

21. The panel that discussed technical assistance issues focused primarily on the discussions that took place at the conference on the coordination of secured transactions reform efforts that was held on 9 and 10 February 2017 at the University of Pennsylvania Law School. The conference was co-sponsored by the International Insolvency Institute, the National Law Center for Inter-American Free Trade and the Organization for the Harmonization of Business Law in Africa (OHADA).

22. A consensus view emerged that coordination in connection with the preparation of secured transactions instruments by international organizations (e.g. by UNCITRAL, Unidroit, and the Hague Conference on Private International Law) was extremely important to first avoid overlap and conflict, and to then facilitate coordination in connection with the implementation of those instruments.

23. The coordination of efforts among international governmental organizations, such as UNCITRAL, Unidroit and the Hague Conference, reflected in their annual coordination meetings and their Joint Publication on Security Interests, was generally thought to constitute a fine example of coordination in the preparation of texts. There was agreement that these annual coordination meetings should continue and the Joint Publication should be updated to include further texts prepared by these three organizations relating to security interests. A suggestion was made that the Joint Publication should also include references to regional security interest texts.

24. The coordination of efforts between international governmental organizations and regional intergovernmental organizations was also discussed and problems were identified that called for increased coordination efforts. There was general agreement that, while regional harmonization efforts were useful, they could not take the place of international harmonization efforts. There was also agreement that international or regional development financing institutions should use to the maximum extent possible international and regional legislative standards.

25. A potential tension was identified between the unitary, functional and comprehensive approach to secured transactions law reform (e.g. the Model Law) and asset-specific approaches (e.g. the Cape Town Convention and Protocols) or more simplified and less comprehensive but not asset-specific approaches. There was agreement that, while the unitary, functional and comprehensive approach should not be undermined, there was room for limited and narrow exceptions (e.g. for high-value, uniquely identifiable equipment that crossed national borders in its normal use). There was also agreement that discussion should continue on the relative merits of other more simplified and less comprehensive approaches and the contexts in which they might be suitable.

26. There was also agreement that secured transactions law reforms should be coordinated with related reforms (e.g. laws on immovable property, including mortgages, etc.), insolvency laws, general reforms for improving the responsiveness and integrity of judicial systems, in particular as they may be utilized for the enforcement of a security right.

27. Several suggestions were made as to the possible next steps. One suggestion was to organize another conference, such as the February 2017 conference at the University of Pennsylvania Law School, perhaps with a view toward holding such conferences in the future on an annual basis. Another suggestion was that a repository of information should be developed, such as the one established by the International Insolvency Institute (at https://www.iiiglobal.org/node/2036). Yet another suggestion was that an ad hoc informal committee of representatives of principal organizations should be formed to discuss and plan the next steps and ongoing coordination efforts. Finally, the suggestion was made that there should be a standardized annual reporting system by all relevant organizations on the progress and developments in secured transactions law reform efforts.

C. Challenges in integrating a new secured transactions law into an existing legal system

28. At the outset, the panel that discussed the challenges in integrating a new secured transactions law into an existing legal system noted the need for those promoting secured transactions law reform in a State to work with the local administration and local lawyers and to refrain from offering a State with a developing economy a level of sophistication it does not need and is not equipped to use. The panel then went on to discuss the following three topics: (a) the lessons to be learned from the Australian experience in devising and implementing its Personal Property Securities Act 2009 ("PPSA"); (b) the importance of adopting a functional rather than a conceptual approach to secured transactions law reform; and (c) the need to adapt concepts, enforcement rules and legislative drafting style of an Article 9 UCC-type Model Law when introducing its ideas into a civil law jurisdiction.

1. The Australian Personal Property Security Act

29. A motive behind the Australian PPSA, a federal jurisdiction in which each State had its own personal property security law, was the need to streamline, simplify and modernize Australia's outdated secured transactions laws and registers. Particularly important was the task of building consensus, which itself required time and effort in disseminating detailed information about the proposed legislation and the need not only to listen to concerns from the private sector but also to involve it in the drafting process. Introducing a reform of this nature into a complex and developed economy had been a very challenging and complex process, and greater involvement of the private sector in the development of the legislation would have enabled the Act to better reflect the realities of the marketplace and business practice. The view of users is that the registry system also ended up to be too complex and not sufficiently user-friendly, though the Registrar and registry staff had been very receptive to industry input and had been working hard to improve this situation.

30. Awareness of the legislation among small businesses had been limited but had significantly improved as a result of education programmes. The lessons learned from the experience with the Australian PPSA were the need to have a deep understanding of what was proposed, to listen to and involve the private sector, to conduct an extensive education programme and to allow plenty of time to ensure that the legislation meets commercial needs.

2. The functional approach to secured transactions law reform

31. The second theme to emerge from the panel presentations was the need to adopt a functional approach to secured transactions law reform. In essence the goal was not to seek to reconcile differences in legal concepts but to provide best solutions to typical problems; in other words, to produce a results-based harmonization rather than one founded on legal doctrine. The Model Law does indeed adopt a functional approach to the concept of security, treating as secured transactions all those fulfilling a security function, including title-retention devices. This functional approach should be applied not only to the characterization of a transaction but also to the priority rules.

32. UNCITRAL plays numerous important roles in the harmonization and modernization of legal rules on secured transactions, including the offering of methodologies of modernization and harmonization, but it was also important to ensure that any rules proposed were acceptable to private actors in the marketplace. This part of the panel discussion concluded with a brief comment on the modernization of secured transactions law in Japan and a question as to why in certain jurisdictions asset-based lending and priority was more popular than debtor-based lending and priority.

3. The adaptation of the secured transactions model law to civil law systems

33. The last part of the panel session was devoted to the necessary acculturation of the Model Law on secured transactions to the philosophy and concepts of civil law systems. It was stated that the Model Law is not a standard model that could be incorporated as it stood. For civil law jurisdictions it was too close to Article 9 of the Uniform Commercial Code and needed to be "de-Americanised" both for political and for technical reasons. The "re-civilisation" of the instrument was said to pose significant challenges both as to substance and as to form. First, there needed to be an acculturation of concepts. Questions that need to be addressed include: (a) the characterization of the new security interest; (b) whether civil law systems should adopt a unitary approach to security or retain a non-unitary approach; and (c) the way in which the concept of proceeds was to be explained and addressed. It was also pointed out that there is also a choice to be made between clarity and readability with a short and simple text, and completeness and legal security with an elaborate and detailed text. In this respect, questions that need to be addressed include: (a) whether there were provisions that could be rejected as unnecessary in a civil law jurisdiction; and (b) the placement of a new law in a civil code, a commercial code or as a stand-alone text.

34. The final question posed was the role of UNCITRAL in the provision of technical assistance to legislators. It was noted that the draft Guide to Enactment would provide significant assistance. The question was raised whether it would be helpful to have an official commentary for the benefit of users, in view of the limited resources of UNCITRAL. It was also noted that academics world could provide a valuable resource with the establishment of a cadre of academics around the world appointed by UNCITRAL and working pro bono. This could provide a resource to which governments and legislators could turn.