

AMERICAN BAR ASSOCIATION

ADOPTED BY THE HOUSE OF DELEGATES

February 4-5, 2002

RESOLVED, that the American Bar Association recommends that the United States sign and ratify the United Nations Convention on the Assignment of Receivables in International Trade.

REPORT

The United Nations Convention on the Assignment of Receivables in International Trade (the "*Convention*") was drafted by the Working Group on International Contract Practices of the United Nations Commission on International Trade Law (UNCITRAL) from 1995 to 2001 and was adopted by the Commission in July of 2001. It is expected formally to be adopted by the General Assembly of the United Nations in the Fall of 2001 and to be opened for signature for a period of two years.

OVERVIEW

The Convention will be of assistance to parties, inside and outside of the United States, which participate in cross-border transactions involving the assignment of receivables, whether as collateral security for loans or other extensions of credit or in transactions in which receivables are sold. The Convention fills many aspects of the vacuum that exists in the laws of many countries where modern secured transactions legal rules governing the assignments of receivables is lacking or not well developed. The Convention is also largely compatible with the laws of countries that have a developed body of law governing such transactions. In particular, the Convention is largely compatible with Article 9 of the Uniform Commercial Code as set forth in the 2000 Official Text.

The transactions most affected by the Convention will be those involving cross-border asset-based loans, factoring, securitization and project finance. The uniform rules of the Convention will provide greater certainty for parties participating in those transactions and will reduce the costs of completing the transactions. In some cases the Convention will enable transactions to be concluded that might not otherwise occur at all.

DISCUSSION

What follows is an overview of the some of the problems addressed by the Convention, a summary of the provisions of the Convention, and discussions of the provisions of the Convention which are consistent with or differ from current U.S. domestic commercial law. It is not believed that the differences between the rules of the Convention and current U.S. domestic commercial law should deter the United States from signing or ratifying the Convention.

Problems Addressed by the Convention

As the preamble to the Convention indicates, the Convention's goal is "to promote the availability of capital and credit at more affordable rates" in cross-border transactions involving the assignments of receivables. This goal arises because of the absence of treaty or domestic law that, on a global basis, provides a uniform set of rules to govern modern commercial practices involving the cross-border assignment of receivables. The void in the law in this area creates legal barriers and uncertainties. As a result, many proposed transactions involving cross-border receivables assignments cannot be concluded or, if

concluded, are concluded with considerable expense involving elaborate structures or multiple law compliance. The absence of appropriate legal rules is especially notable in several respects.

Treaty Law. As a general matter, no current multinational treaty or convention provides uniform rules for the assignment of receivables that cover the breadth of the transactions contemplated by the Convention. The Unidroit Convention on International Factoring and the Unidroit Convention on International Financial Leasing deal with receivable assignments. But these conventions address only narrow areas of practice, generally govern only the relationships among the parties and not third party interests, and have not been widely adopted. Neither convention, in fact, has been ratified by the United States. The proposed Unidroit Convention on International Interests in Mobile Equipment is expected to be completed at a diplomatic conference in October of 2001. However, that convention addresses assignments of receivables arising only from or as an incident to the sale or other distribution of "high ticket" mobile equipment such as aircraft, space property and railroad rolling stock.

Domestic Commercial Law. Although the United States has a highly developed modern secured transactions law dealing with assignments of receivables, this is not true in many other countries. In many countries, the ability of an assignor to assign receivables without specific identification or in bulk, the ability of an assignor to assign future receivables by a present assignment, the ability of an assignor to assign receivables notwithstanding anti-assignment terms in the contracts giving rise to the receivables, and the ability of the assignee to make a proprietary claim to the proceeds of receivables assigned to it is either nonexistent or questionable. In many countries, various rights and obligations of account debtors and other persons obligated on assigned receivables, especially when confronted with notices of assignment and payment instructions to pay assignees, is not well developed.

Choice of Law. Even if the laws are well developed in countries affected in a particular cross-border transaction involving the assignment of receivables, the laws may differ among those countries. There are no currently adequate uniform choice of law rules to inform the parties which country's laws will govern on a particular issue. Although a number of treaties address choice of law issues, they often do so in the context of the relationship among the parties to a transaction without addressing choice of law issues to determine the interests of third parties, or they address choice of law issues in the context of a narrow category of specialty transactions. Moreover, while domestic laws of many countries often address perfection and priority issues relating to the assignments of receivables, the domestic laws of a particular country may not be given effect if the challenge to the assignment arises in a court in another country. As a consequence, guidance is often lacking in cross-border transactions, where there is a risk of a challenge to the assignment arising in a forum in more than one country. This lack of guidance is especially problematic when the various possible forums do not have a uniform approach on such choice of law issues as what country's laws govern whether an assignment of receivables is a true sale or a secured loan or other extension of credit, whether the assignee

prevails over a lien creditor or insolvency administrator or what the assignee's priority in assigned receivables is in the event of a priority dispute with a competing assignee.

The Convention addresses all of these issues. It provides uniform substantive rules in areas where delegations were able to reach consensus. In some areas, such as the substantive law for perfection or priority, where consensus could not be achieved, the Convention provides a workable uniform choice of law rule. It also provides optional uniform rules for those countries that wish to develop their substantive law on perfection and priority and choice of law rules even further. The Convention's approach is more specifically described in the summary which now follows.

Summary of the Convention

The following is a summary of the basic provisions of the Convention.

Objectives. As the preamble to the Convention indicates, the objective of the Convention is to provide, for assignments of receivables, uniform rules that will have the effect of increasing the availability of credit and reducing the costs of credit while at the same time avoiding disruption of existing financing practices, fostering the development of new financing practices and protecting the interests of debtors.^{1/}

Receivables and Assignments Covered. The Convention addresses the assignment of receivables which are contractual rights to payment. Covered assignments include both the creation of security interests in receivables and "true sales" of receivables. However, by excluding transactions in securities, derivatives and other financial assets, assignments of deposit accounts, and assignments of claims under letters of credit and independent guaranties, and by protecting those who are holders of negotiable instruments or assignees of real estate lease receivables, the Convention rules relate primarily to assignments of trade, loan and similar commercial and consumer receivables arising in asset-based lending, factoring, securitization and project finance transactions.

Internationality. For the Convention to apply to an assignment of a receivable, either the assignment or the receivable must be international, i.e., the assignor and assignee must be located in different States or the assignor and the debtor must be located in different States. Also, for the Convention to apply, the assignor must be located in a Contracting State and, for the rights or obligations of the debtor to be affected by the Convention, either

^{1/} The Convention refers to the person who assigns a receivable as the "assignor," the person to whom the receivables is assigned as the "assignee," and the person who owes the receivable as the "debtor." The contract that gives rise to the receivable is referred to as the "original contract." The Convention also refers to countries as "States" and to those countries that sign and ratify the Convention as "Contracting States."

the debtor must be located in a Contracting State or the original contract must be governed by the law of a Contracting State. The Convention provides specific rules to determine where an assignor, assignee or debtor is located. Under these rules, an assignor or assignee that is a legal entity is located in the State in which it has its central administration, i.e., its chief executive office.

Rules Among Assignor, Assignee and Debtor. The Convention provides specific rules that set forth when and by whom the debtor may be notified of an assignment and whom the debtor must pay, following the assignment, in order to obtain a discharge on the receivable. The debtor's setoff and recoupment rights are generally preserved. Furthermore, agreements of a debtor not assert claims and defenses against an assignee are generally validated.

Future Receivables and Bulk and Partial Assignments of Receivables. The Convention overrides domestic commercial laws that would otherwise not permit an assignment of receivables in bulk, a present assignment of future receivables, or an assignment of partial or undivided interests in receivables. The Convention provides that the contract of assignment between the assignor and the assignee need not describe the receivables specifically; rather, the receivables may be described generally so long as they may be identified to the contract of assignment. A new contract of assignment need not be executed when there is a present assignment of a future receivable and the future receivable thereafter arises or is created and can be identified to the contract of assignment.

Anti-Assignment Clauses. The Convention generally overrides contractual clauses that restrict assignments of receivables arising from the sale or lease of goods, credit card receivables or receivables arising out of the licensing of intellectual property. It does not override domestic statutes or rules of law restricting assignments.

Choice of Law for Priority. The Convention provides that the priority of an assignee's interest in a receivable as against a lien creditor, insolvency administrator or competing assignee is determined by the law of the State in which the assignor is located. That law also determines whether the assignment is a "true" sale or a secured transaction. If a challenge to the priority of an assignment is made in a court located in a State other than the State in which the assignor is located, the court may not refuse to apply the priority rules of the State of the assignor's location unless those rules are "manifestly contrary to the public policy of the forum State." However, if an insolvency proceeding is commenced by or against an assignor in an insolvency tribunal located in a State other than the State in which the assignor is located, the insolvency tribunal may charge the receivables with wage, tax or other preferential claims if otherwise required under the forum State's insolvency laws.

Proceeds. The Convention gives the assignee a right in the proceeds of an assigned receivable that are paid to the assignee directly or that are held by the assignor on instructions by and for the benefit of the assignee in a segregated lock box or in any other manner in which the proceeds are segregated from the assets of the assignor. The assignee's right in the proceeds has under the Convention the same priority as the assignee's right in

the receivable to which the proceeds related. Nevertheless, the Convention does not address a priority conflict between an assignee claiming an interest in property as proceeds of an assigned receivable and a depositary bank, securities intermediary or other person, claiming an interest in the property as original collateral or otherwise not as proceeds of the receivable, through a right of setoff or a transfer of an interest in the property by agreement.

Consumer Protection. The provisions of the Convention do not alter rights and obligations of parties to consumer transactions under domestic consumer protection laws.

Optional Provisions. The Convention sets forth optional choice of law rules to be applied in cross-border receivable assignment transactions even if the Convention would not otherwise apply. The Convention also sets forth in an optional annex a menu of substantive priority rules that a State may choose to apply, including a priority rule based upon the first to file in a notice filing system. In addition, the annex contains provisions for the establishment of an international filing system and general rules for its operation.

Transition. The Convention contains transition rules that protect the expectations of parties in transactions entered into before the Convention comes in effect in the relevant countries.

General Consistency with U.S. Domestic Commercial Law

Domestic commercial law in the United States relating to the assignment of receivables within the scope of the Convention is largely based upon the 2000 Official Text of Article 9 of the Uniform Commercial Code (“*Article 9*”). Article 9 has been enacted with some minor variations in all fifty states and the District of Columbia. Accordingly, it is important to focus upon the consistency between the provisions of the Convention and the provisions of Article 9.

It is believed that, for all practice purposes, Article 9 and the Convention are consistent. Fortunately, the Convention was being negotiated at the same time as Article 9 was being revised from the 1995 Official Text. Not only did the two efforts coincide chronologically over several years but the members of the U.S. delegation to the UNCITRAL Working Group were active participants in the revision of Article 9.

The Convention’s consistency with Article 9 is achieved in several ways. First, the substantive rules of the Convention largely coincide with those of Article 9. Second, in cases where the Convention provides no substantive rule, Article 9, if applicable under the Convention’s choice of law rules or otherwise, applies. Third, in some cases, Article 9 is broader in scope than the Convention. In those cases, of course, there will be no inconsistency between the Convention and Article 9 since Article 9, if otherwise applicable, will apply.

Provisions of the Convention which Differ from U.S. Domestic Commercial Law

Several provisions of the Convention differ from those in Article 9 or otherwise found in U.S. domestic commercial law.

Assignor Location Rules. In some cases, an assignor would be determined to be located in a different country than the country in which an Article 9 assignor is viewed to be located. In that case, if the Convention were adopted, it will be necessary for an assignee, under the Convention choice of law rules for perfection and priority, to comply with the perfection and priority rules of the country in which the assignor is located as determined by the Convention rather than the perfection and priority rules in which the assignor is located as determined under the Article 9 location rules.

However, the impact of these differences is mitigated in three ways. First, as the chart attached hereto as Exhibit A indicates, the categories of cases in which the differences would arise would be small. For most transactions, the Convention location rules coincide with those of Article 9. For example, a corporation or other legal entity organized under the laws of a state of the United States with its chief executive office in the United States would be viewed under both the Convention and Article 9 as located in the United States. Similarly, an individual working and living in the United States would be viewed under both the Convention and Article 9 as located in the United States.

Second, the impact of what differences there are is much less given the ability of the United States to declare, in connection with the signature and ratification process, that its own internal choice of law rules within the United States will apply for any transaction in which an assignor is viewed under the Convention to be located in the United States. Consider an assignor corporation organized in Delaware with its chief executive office in New York. Under the general Convention location rules the assignor would be viewed to be located in New York, but under Article 9's choice of law rules the assignor would be viewed to be located in Delaware. The Convention permits the United States, as it is understood that it will do as part of the signature and ratification process, to file a declaration that permits the Article 9 choice of law rules to apply so long as the location of the assignor remains in the United States. Accordingly, after giving effect to the contemplated declaration, the assignor would under the Convention location rules be viewed to be located in Delaware as it would under Article 9.

Third, parties can foresee these differences and structure their transactions accordingly. In many instances, this is what well advised parties are already doing on cross-border transactions. For example, a U.S. branch of a German company may assign its receivables generated by that branch to an assignee in the United States. Because Germany does not maintain a public filing system by which a secured party, which files in that system, prevails over a subsequent lien creditor, the German company would be viewed under Article 9 to be located in the District of Columbia. The assignee would then file a financing statement in the District of Columbia to perfect its security interest. However, an assignee that does not also take steps under German law to perfect the assignment would be

imprudent. That would be because an insolvency administrator in Germany might not recognize the U.S. security interest and might claim the receivables notwithstanding the perfection steps taken in the United States. Given this risk and if well advised, the assignor would today take the appropriate steps to perfect the assignment under German law. Under the Convention taking those steps would be required.

Assignments of Undivided Interests in Receivables. The Convention expressly permits assignments of undivided interests in receivables, e.g., an assignment of a percentage interest in a pool of receivables. Under U.S. domestic commercial law, there is considerable uncertainty as to whether an undivided interest in a receivable may be sold. The Convention would validate such a sale in transactions to which the Convention applies.

Perfection and Priority Rules for Nonnegotiable Instruments and Chattel Paper. In some cases, an assignee will obtain an assignment of receivable evidenced by an instrument or tangible chattel paper and will seek to perfect that assignment, as permitted under Article 9, by means of the assignee's possession of the instrument or tangible chattel paper. Under Article 9's choice of law rules, perfection and priority of a possessory security interest in an instrument or tangible chattel paper is governed by the law of the jurisdiction in which the instrument or tangible chattel paper is located. However, if the Convention were adopted by the United States and the assignor were located, as determined under the location rules of the Convention, in a country outside of the United States, the assignee would not be able generally to rely upon possession of the instrument or tangible chattel paper to insure the perfection and priority of the assignment. Instead, it will be necessary for an assignee to comply with the perfection and priority rules of the country in which the assignor is located as determined by the Convention.

Once again, the impact of these differences is mitigated. The Convention itself will protect the assignee if the instrument or any instrument comprised in the tangible chattel paper is a negotiable instrument and the assignee is protected under negotiable instrument law, such as would be the case for a holder in due course of the negotiable instrument under Article 3 of the Uniform Commercial Code. Moreover, most nonnegotiable instruments and tangible chattel paper being assigned in the United States are being assigned by assignors that would be viewed under the Convention location rules to be located in the United States.

However, if the Convention were to be adopted in the United States, assignees that take assignments of nonnegotiable instruments and tangible chattel paper from assignors located, under the Convention location rules, in other countries will need to be educated as to the Convention's choice of law rules for perfection and priority and the need for the assignee to comply with the perfection and priority rules of the country whose laws apply to those issues under the Convention's choice of law rules.

Priority Rules for Transferable Records. In some cases, an assignee will obtain an assignment of a receivable evidenced by "transferable record" as defined in § 7021 of the Electronic Signatures in Global and National Commerce Act ("*E-Sign*") or in § 16 of the United Electronic Transaction Act ("*UETA*"), as enacted in various states in the United States. Under the provisions of *E-Sign* a person in control of an electronic record that, if in

paper form, would otherwise be a negotiable promissory note would be given the priority status of a holder in due course under Article 3 of the Uniform Commercial Code, if the payment obligation were secured by an interest in real estate. Under the provisions of UETA a person in control of an electronic record that, if in paper form, would otherwise be a negotiable promissory note, a negotiable document of title or tangible chattel paper would be given the priority status of a holder in due course under Article 3 of the Uniform Commercial Code, a person to whom a negotiable document of title was duly negotiated under Article 7 of the Uniform Commercial Code, or, as the case may be, a person entitled under Article 9 to a possessory priority interest in an instrument or chattel paper.

However, if the Convention were adopted by the United States and the assignor were located, as determined under the location rules of the Convention, in a country outside of the United States, the assignee would not generally be able to rely upon the control priority provisions of E-Sign or UETA. It is unlikely that the Convention rules protecting a holder of a negotiable instrument would protect the assignee of a transferable record that, if in paper form, would be a negotiable instrument. Nor would any other rule of the Convention protect the assignee. Rather, it will be necessary for an assignee to comply with the perfection and priority rules of the country in which the assignor is located as determined by the Convention.

It is doubted that the impact of the Convention's choice of law rule for perfection and priority of an assignment of a transferable record will be significant for several reasons. First, transferable record transactions in the United States at the current time do not appear to be prevalent in any important respect outside of perhaps certain real estate mortgage loan transactions. Second, any volume of transferable record transactions in the United States would likely occur with assignors that are viewed under the Convention location rules as located in the United States. Third, given that neither E-Sign nor UETA contains choice of law rules and that a challenge to the assignment could occur in a forum that does not apply E-Sign or UETA, a well advised assignee might in event today need to comply with laws of the country in which the assignor is located (and even perhaps the laws of other jurisdictions) to assure itself of perfection and priority of the assignment when the assignor is not located in the United States.

In any event, if the Convention were to be adopted in the United States, assignees that take assignments of transferable records from assignors located, under the Convention location rules, in other countries will need to be educated as to the Convention choice of law rules for perfection and priority and the need for the assignee to comply with the perfection and priority rules of the country whose laws govern those issues under the choice of law rules of the Convention.

Rule Relating to When an Assignee May Notify the Debtor of the Assignment.

Under the Convention, absent agreement between the assignor and the assignee to the contrary, the assignee may notify the debtor of the assignment and instruct the debtor as to whom to pay. Under Article 9, absent agreement to the contrary, the assignee may not notify the debtor of the assignment or instruct the debtor as to whom to pay unless a default has occurred. Given that most assignments address these issues as a matter of contract in

any event, this difference in rules under the Convention and Article 9 is not viewed to be important in practice.

Rules Relating to Modifications of Contracts Binding Upon Assignees. A receivable will typically arise under a contract between the debtor and the assignor. Under the Convention, before the debtor is notified of the assignment, any modification of that contract between the debtor and the assignor is binding on the assignee. Under Article 9, before the debtor is notified of the assignment, the assignee is bound only if the modification is made in “good faith,” defined in Article 9 as “honesty in fact and the observance of reasonable commercial standards of fair dealing.” Moreover, under the Convention, after the debtor is notified of the assignment, a modification of the contract between the debtor and the assignor is binding on the assignee if the receivable is not fully earned and a reasonable assignee would consent to the modification. Under Article 9, the assignee would not be bound unless the modification were made in “good faith.” Given the subtleties of these differences, it is believed that they will not have any material impact in practice.

Transactions Outside of the Scope of Article 9 but Covered by the Convention. Some transactions are excluded from Article 9 but included in the Convention. For example, Article 9 excludes contractual assignments of wage claims. Cross-border transactions involving the assignment of wage claims would be covered by the Convention. However, the Convention would not override statutory restrictions on wage assignments under federal or state law in the United States. Similarly, Article 9 excludes contractual assignments most insurance claims. The Convention would cover such assignments in cross-border transactions. Nevertheless, significant differences are not seen between the Convention rules for assignments of insurance claims and the rules that would apply under U.S. domestic commercial law other than Article 9.

Language and Terminology Differences. As with any international treaty or convention, differences emerge in language and terminology from that used in domestic law. Especially given that the Convention will be issued in the six United Nations official languages – English, Spanish, French, Russian, Arabic and Chinese, such differences are inevitable. Moreover, in order to avoid overly complex provisions inhibiting accurate translation and understanding, some provisions of the Convention are stated in general language. Indeed, some phrases and uses of terminology are untested. Nevertheless, any particular concerns over language or terminology are being addressed by the official commentary issued by UNCITRAL and which is currently being developed. Although it is not possible to predict with certainty, it is not believed that these language and terminology differences will prove consequential in application.

IMPLEMENTATION ISSUES

Execution and Implementation of the Convention

The Convention is self-executing. No special state or federal legislation would be necessary for parties in the United States to bound by the Convention rules. Furthermore, the Convention would have no federal or state budgetary implications or any other resource implications.

CONCLUSION

The ratification of the Convention by the United States would remove legal barriers and create greater certainty in cross-border transactions involving the assignments of receivables. Although the Convention may contain some differences from U.S. domestic commercial law, it is believed that these differences are not significant. It is asked that the American Bar Association adopt the recommendation for the Convention's prompt signature and ratification by the United States.

Respectfully submitted,

A handwritten signature in black ink, reading "Robert E. Lutz". The signature is written in a cursive style with a large initial "R" and a long, sweeping underline.

Robert E. Lutz
Chair, Section of International Law & Practice

February 2001

Exhibit A

CHART REFLECTING DIFFERENCES IN ASSIGNOR LOCATION RULES BETWEEN THE CONVENTION AND ARTICLE 9

Assignor	Location of the Assignor under the Convention	Location of the Assignor under Article 9
Individual	The individual's place of business or, if the individual has more than one place of business, the place where the individual centrally administers his or her business. If the individual does not have a place of business, the individual is located where the individual habitually resides.	The individual's residence or, if there is more than one, the individual's primary residence. Whether the individual has a business is not relevant.
Corporation, limited partnership, limited liability company, statutory business trust organized in the U.S.	The assignor's place of business or, if the assignor has more than one, the place of the central administration of the business.	State in which the assignor is organized.
Corporation or other legal entity organized outside of the U.S.	The assignor's place of business or, if the assignor has more than one, the place of the central administration of the business.	The same as the Convention. However, if the country so determined does not have public filing system by which a secured party who filed in that system prevails over a subsequent lien creditor, then the assignor is viewed to be located in the District of Columbia.
U.S. branch of a foreign bank	The assignor's place of central administration, i.e. its global head office.	Depending upon the operations and licensing of the branch, the branch is located in a particular state or in the District of Columbia. It is not located where the foreign bank's global head office is located.
Foreign air carrier under the Federal Aviation Act of 1958, as amended	The assignor's place of business or, if the assignor has more than one, the place of the central administration of the business.	The state in which is located the designated office of the carrier's agent for service of process.

