

The utility and efficacy of the UN Convention on the Assignment of Receivables and the Facilitation of Credit

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1. Introduction

Assignment of receivables is at the core of commercial law. Raising finance through assignment of receivables is a vital financing technique for small businesses and routinely used by companies in financing their businesses.¹ Receivables financing also has a significant role in economic growth. As one commentator pointed out raising finance through assignment of receivables ‘is simply bigger business than the financing of mobile goods.’² Receivables financing has seen considerable growth as ‘receivables are self-liquidating and ... an excellent short-term source of cash.’³ Divergence in the regulation of the law of assignment in national systems causes uncertainty and increases the cost of credit in cross-border assignment of receivables contracts, hence the need to have a modern and sophisticated international

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¹ Law Commission Report on Company Security Interests No. 296 (2005), para.4.1 (‘Law Commission Report’)

² N.B. Cohen, ‘Harmonizing the Law Governing Secured Credit: The Next Frontier’ 33 *Tex. Int’l. L. J.* 173, 185 (1998).

³ S. Schwarcz, ‘Towards a Centralized Perfection System for Cross-Border Receivables Financing’ 20 *U. Pa. J. Int’l Econ. L.* 455, 456 (1999). For the significance of receivables financing *see also* F. Oditah, *Legal Aspects of Receivables Financing*, at 2 (London: Sweet and Maxwell, 1991).

instrument. Businesses, particularly, in developing economies, have difficulty to access to obtain finance mainly because intangibles are not widely accepted as collateral.⁴ The majority of world trade relies on credit supplied by banks and other financial institutions to SMEs that comprise 90 percent of businesses and 50 percent of employment globally.⁵ Movable and intangible assets and their use as collateral may have positive impact on production and growth.⁶ Lack of modern enforceability mechanisms to deal with security based on intangibles and receivables or unclear nature of the law may be cited as particular issues that hinder businesses to access to credit. With the continuous effects of credit crisis, the access to credit for businesses has become a significant problem in both developed and developing economies.⁷

The United Nations Commission on International Trade Law (UNCITRAL) has prepared the United Nations Convention on the Assignment of Receivables in International Trade (the Receivables Convention) after almost a decade of careful work.⁸ It was adopted in 2001.⁹ The

⁴ See e.g. M. Safavian, 'Firm-level evidence on collateral and access to finance' in F. Dahan and J. Simpson (eds) *Secured Transactions Reform and Access to Credit*, 110, 113 *et seq* (Edward Elgar, Cheltenham, 2008).

⁵ http://www1.ifc.org/wps/wcm/connect/277d1680486a831abec2fff995bd23db/SM12_IFCIssueBrief_SMEs.pdf?MOD=AJPERES (last accessed 4 June 2012)

⁶ H. Fleisig, 'The Economics of collateral and of collateral reform' in Dahan and Simpson (eds), *ibid*, 81, 89 *et seq*.

⁷ According to Federation of Small and Medium Sized Businesses statistics, small businesses in the UK have serious problems in access to credit. <http://www.fsb.org.uk/> Report on *Number Crunching the Credit Crunch* (last accessed May 2012)

⁸ For the background of the project and its inception point *see* Report of the Secretary General: Study on Security Interests (A/CN.9/131 and Annex). Previous attempts are a uniform conditional sales act enacted by Norway, Sweden and Denmark between 1915 and 1917; Unidroit Draft provisions of 1939 and 1951 concerning the impact of reservation of title in the sale of certain goods; provisions regarding the effect of bankruptcy of

Receivables Convention promotes a sophisticated model for the modernisation of domestic assignment laws as well as overall harmonisation of the law of assignment of receivables in international trade. It can, arguably, be considered as a substantive step towards facilitation of cross-border flow of credit and access to low cost credit. The widespread application of the Receivables Convention may lead to greater predictability and certainty in cross border assignment of receivables. It covers outright and security transfers of receivables. The Receivables Convention removes legal obstacles to certain international financing practices, including securitisation, factoring and project financing, by validating the assignment of future receivables and bulk assignments and assignments made notwithstanding anti-assignment agreements. It also introduces rules that unify the effectiveness of an assignment as between the assignor and the assignee, and as against the debtor. Legal predictability is also enhanced in the facilitation of credit by setting the law applicable to priorities between competing claims.¹⁰ The Receivables Convention has adopted a mixture of rules on the formal

reservation of title in the sale of goods in the draft EEC Bankruptcy Convention of 1970 and model reservation of title clauses contained in several General Conditions elaborated by the UN Economic Commission for Europe. H.S. Burman, 'The Commercial Challenge in Modernizing Secured Transactions Law' *Unif. Law Rev.* 347, 348-9 (2003).

⁹ A/RES/56/81

¹⁰ On these issues *see e.g.* S. Bazinas, 'Key Policy Issues of the United Nations Convention on the Assignment of Receivables in International Trade' 11 *Tul. J. Int'l & Comp. L.* 275 (2003); S. Bazinas, 'UNCITRAL's Work in the Field of Secured Transactions' 36 *UCC.L.J.* 67 (2004); S. Bazinas, 'An International Legal Regime For Receivables Financing: UNCITRAL's Contribution' 8 *Duke J. Comp. & Int'l L.* 315 (1998); S. Bazinas, 'Lowering the Cost of Credit: the Promise in the Future UNCITRAL Convention on Assignment of Receivables in International Trade' 9 *Tul. J. Int'l & Comp. L.* 259 (2001); S. Bazinas, 'UNCITRAL's Contribution to the Unification of Receivables Financing Law: The United Nations Convention on the Assignment of Receivables in International Trade' (2002) *Unif. L. Rev.* 49; F. Ferrari, 'The UNCITRAL Draft Convention on Assignment in Receivables Financing: Applicability, General Provisions and the Conflict of Conventions' 1 *Melbourne J. Int'l*

validity of assignments and priority of the assignee's right in the assigned receivable against other competing claimants. In addition to a conflict-of-laws approach, there is an optional annex that serves as a model for substantive priority rules. The Convention also offers a model for the registration of security interests for the purposes of obtaining priority.¹¹

This chapter will discuss the general principles of the Convention in facilitating the availability and lowering the cost of credit. In particular the chapter will seek to identify the utility and efficacy of the Receivables Convention in the availability of credit in the face of the current credit crisis. The recurrent theme is that modern rules that efficiently endorse receivables financing are critical in the reduction of cost of credit and have the potential to increase cash flow and further investment in the face of financial crisis.

2. Availability of Credit and the need for a predictable regime

Ability to access to credit for businesses is essential for a number of reasons. Firstly, the ability to obtain credit is said to enable businesses to expand their operations and help create economic growth.¹² If the law provides favourable rules for the lender to be able to take security, credit may be extended at lower cost. Thus, secured credit leads economic activity

L. 1 (2001); F. Ferrari, 'The UNCITRAL Draft Convention on Assignment in Receivables Financing: Critical Remarks on Some Specific Issues' in J. Basedow, I. Meier, A.K. Schnyder, T. Einhorn and D. Girsberger (eds), *Private Law in the International Arena-Liber Amicorum Kurt Siehr*, The Hague: T.M.C. Asser Press, 2000, 179; M. Deschamps, 'The Priority Rules of the United Nations Receivables Convention', 12 *Duke J. Comp. & Int'l L.* 389 (2002).

¹¹ Article 42(4).

¹² See generally R. Levine, 'Finance and Growth: Theory and Evidence' *National Bureau of Economic Research, Working Paper 10766*, 85 (2004).

and increases the opportunities for lending, while decreasing the risk of default.¹³ Security is a necessary tool to prevent defaults of debtor. This is because with the ability to take security, the risk of non-payment of credit will be reduced, as the lender will have a right to recourse to the collateral.¹⁴ The debtor in the course of ordinary business may not take a decision that puts the collateral at risk.¹⁵ The existence of the collateral and the lender's control over it may facilitate the access to credit. Secondly, the availability of credit may be possible if the lender has a priority position. This may be possible if there is security. The lender bargains for a priority position. If the law provides clear rules for lenders to obtain priority, access to credit is likely to be facilitated.¹⁶ Thirdly, the existence of the collateral and the lender's control over it as well as the responsiveness of the law to the needs of the financial community may act as catalysts in the businesses' access to credit. These factors may arguably lead to the lender's reduction of interest rates whereby the risk premium, which acts as a buffer for the lender in

¹³ See U. Drobnić 'Secured Credit in International Insolvency Proceedings' (33) *Tex. Int'l L. J.* 53, at 54 (1998).

¹⁴ U. Drobnić, 'Secured Credit in International Insolvency Proceedings' 33 *Tex. Int'l L. J.* 53, 54 (1998).

¹⁵ See generally A. Schwartz, 'Priority Contracts and Priority in Bankruptcy' 82 *Cornell L. Rev.* 1396 (1997); R.J. Mann, 'Explaining the Pattern of Secured Credit' 110 *Harvard L. Rev.* 625, 683 (1997) where Mann concludes that secured credit '...[enhances] the borrower's ability to give a credible commitment to refrain from excessive future borrowing and by limiting the borrower's ability to engage in conduct that lessens the likelihood of payment.'

¹⁶ However, there are different views on this matter. See e.g. E. Warren, 'Making Policy with Imperfect Information: The Article 9 Full Priority Debates' 82 *Cornell L. Rev.* 1373 (1997); L.A. Bebbchuk and J.M. Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' 105 *Yale L. J.* 857 (1996); J. McDonnell, 'Is Revised Article 9 a Little Greedy?' 104 *Com. L. J.* 241, 262 (1999). In England, by virtue of Enterprise Act 2002, a certain proportion of floating charge realisations has to be set aside for unsecured creditors (s. 252 and s.176A of the Insolvency Act).

case of default,¹⁷ may not be included in the interest rate or the lender may agree to lend with long term maturities.¹⁸ Empirical studies draw a correlation between long term economic growth and the functioning of financial system.¹⁹ Similar studies also established that legal and financial factors among others constrain a firm's growth and the affected firms are consistently small ones.²⁰ The UNCITRAL Guide states that:

[s]tudies have shown as the risk of non-payment is reduced, the availability of credit increases and the cost of credit fall. Studies have also shown that States where lenders perceive the risks associated with transactions to be high, the cost of credit increases as lenders require increased compensation to evaluate and assume the increased risk.²¹

There is a correlation between the borrower's financial strength and the attraction to secured credit. In that context, Professor Mann pointed out that 'borrowers exhibit an

¹⁷ Banks in developing markets charge higher interest rates and fees in order to protect their interests against non-performing debtors. On this point *see* T. Beck, A. Demirguc-Kunt and M.S. Martinez Peria, 'Bank Financing for SMEs around the World' *Policy Research Working Paper 4785* (2008).

¹⁸ There has been a debate in the US on the correlation between 'long term loans' and 'security'. On this *see e.g.* T. Jackson and A. Kronman, 'Secured Financing and Priorities Among Creditors' 88 *Yale L. J.* 1143, 1159 (1979); F.H. Buckley, 'The Bankruptcy Priority Puzzle' 72 *Va. L. Rev.* 1393, 1444 (1986); S.L. Harris and C.W. Mooney, Jr, 'A Property Based Theory of Security Interests: Taking Debtors' Choices Seriously' 80 *Va. L. Rev.* 2021, 2028 (1994); A. Schwartz, 'Security Interests and Bankruptcy Priorities: A Review of Current Theories' 10 *J. Legal Studies* 1, 13-14 (1981).

¹⁹ *See* generally Levine, *ibid.*

²⁰ T. Beck, A. Demirguc-Kunt and V. Maksimovic 'Financial and Legal Constraints to Firm Growth: Does Size Matter?' 60 *Journal of Finance* 137 (2005)

²¹ A/CN.9/WG.6/WP.2 at para. 2

increasing tendency toward unsecured debt as their financial strength increases.’²² Professor Wood notes similarly that public companies usually borrow on an unsecured basis as they have sufficient credit strength and need to spread their sources of finance, they rather use negative pledge clauses in their contracts.²³ The Law Commission observed this motive and reported that ‘well-established public companies are able to borrow readily on an unsecured basis, but for many smaller enterprises credit can be obtained on significantly better terms ...if the borrower is able to offer security to the lender.’²⁴ This is also supported by empirical studies which suggest that security is mainly used by small businesses that carry risk.²⁵ It is also clear that small businesses mainly able to offer receivables owed to them as the only meaningful collateral in order to access to credit. It is, therefore, important to modernise secured credit laws or at least certain aspects of it to promote the availability of capital and make credit at affordable rates.²⁶

²² Mann, *op cit* 15, 674.

²³ P. Wood, ‘*Law and Practice of International Finance*’, London: Sweet and Maxwell, 2008, 253. Fleisig empirically provides that in the USA one-third of credit is unsecured and about two-thirds is secured. H.W. Fleisig, ‘The economics of collateral and of collateral reform’ in F. Dahan and J. Simpson (eds) *Secured Transactions Reform and Access to Credit* Cheltenham: Edward Elgar, 2008, 81, 88.

²⁴ Law Commission Report No. 296 (2005), para. 1.2.

²⁵ J. Armour, ‘The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?’ in H. Eidenmüller and E.M. Kieninger (eds) *The Future of Secured Credit in Europe E.C.F.L.R.*, Munich: De Gruyter Recht, 2008, 3, at 9; M.A. Lasfer ‘Debt Structure, Agency Costs and Firm’s Size: An Empirical Investigation’ *Working Paper* Cass Business School, at 18 (2000). Lasfer concludes that small firms hold more secured and less unsecured debt than larger companies.

²⁶ See e.g. The Preamble of the Receivables Convention ‘*Being of the opinion* that the adoption of uniform rules governing the assignment of receivables would promote the availability of capital and credit at more affordable rates...’.

In terms of receivables financing and the use of receivables as collateral, restrictions over assignment of receivables adversely affect small businesses' access to credit. It was this aspect that led the UNCITRAL to remove obstacles before receivables financing and modernise domestic systems²⁷ and thus 'unlock the dead capital'.²⁸ It has been argued that intangible property acts as the most valuable collateral and has advantages over tangible property.²⁹ Without an adequate system on security interests, States may be deprived of the opportunity to access to low cost credit. Collateral has clear significance in private sector's access to low-cost credit.³⁰ The use of intangibles and movables in some developed countries is more attractive. However, financiers in economically less developed countries rather prefer the use of immovables as collateral.³¹ It has been observed that 'in most countries *intangible capital* is the largest share of total wealth'.³² Between 2001 and 2005, the World Bank

²⁷ A/CN.9/378/Add.3; A/48/17, paras 297-301.

²⁸ M. Safavian, H. Fleisig and J. Steinbuks, 'Unlocking the Dead Capital', *View Point* Note Number 307 (March 2006)

²⁹ L. Gullifer, *Goode on Legal Problems of Credit and Security*, L. Gullifer (ed.), London: Sweet & Maxwell, 4th ed., 2009, 2-3 and 95; H.L. Buxbaum, 'Unification of the Law Governing Secured Transactions: Progress and Prospects for Reform' (2003-1/2) *Unif. L. Rev.* 322, at 324.

³⁰ H. Fleisig, M. Safavian and N. De la Pena, *Reforming Collateral Laws to Expand Access to Finance* Washington DC: The World Bank, 2006, 1 *et seq.*

³¹ See generally e.g. M. Safavian, 'Firm level evidence on collateral and access to finance' in F. Dahan and J. Simpson (eds) *Secured Transactions Reform and Access to Credit* Cheltenham: Edward Elgar, 2008; S. Simavi, 'Making Finance Work for Africa: The Collateral Debate', *World Bank PDP Forum*; 'Vietnam Increasing Access to Credit through Collateral (Secured Transactions) Reform' (IFC/MPDF, 2007); 'Reforming Collateral Laws and Registries: International Best Practices and the Case of China' (FIAS/IFC PEP China, March 2007).

³² *Where is the Wealth of Nations? Measuring Capital For the 21st Century* (2006), 87 available at <http://siteresources.worldbank.org/INTEEI/214578-1110886258964/20748034/All.pdf> (last accessed 10 May 2012).

Enterprise Surveys, conducted in 60 low and middle income countries, established that 22 per cent of company assets are land and buildings, 34 per cent accounts receivables and 44 per cent machinery. Nevertheless, as collateral only nine per cent accounts receivables, 18 per cent machinery and 73 per cent lands and buildings are accepted.³³ The figures provide the evidence that in unreformed regimes there is strong confidence for tangible and immovable assets. However, in terms of modern financing this may be regarded as an inadequate system that fails to promote secured credit and recognise the value of receivables.³⁴ The economic impracticality of pledge of movables has been observed by the UNCITRAL³⁵ and economists.³⁶ Complementing this finding, other empirical studies demonstrate the need to introduce non-possessory security in order to facilitate the availability of credit.³⁷ If the scope of security is expanded by modernising the law, unlimited ability to use any types of assets as collateral, better creditor and predictable priority rights, SMEs in developing economies may have facilitated access to finance as this will stimulate lending practices of banks.³⁸ Limitation on the ability to provide receivables or inventory as collateral has been illustrated in the

³³ M. Safavian, H. Fleisig and J. Steinbuks 'Unlocking Dead Capital' *Viewpoint*, Note Number 307 (March 2006), at 2 and Figure 3.

³⁴ For the key objectives of an effective and efficient secured transactions regime see A/CN.9/631 recommendation 1.

³⁵ UNCITRAL Legislative Guide on Secured Transactions, Chapter I, paras. 57 and 62, at 44 and 46.

³⁶ H. Fleisig, 'The economics of collateral and of collateral reform' Dahan and Simpson (eds), *pop cit* 4 at 90 arguing that movable assets cannot effectively serve in unreformed economies as collateral; see also H. Fleisig, 'The Proposed Unidroit Convention on Mobile Equipment: Economic Consequences and Issues' *Unif. L. Rev.* 253, 256 (1999).

³⁷ Armour, *op cit* 25, at 14-19.

³⁸ See generally R. Haselmann, K. Pistor and V. Vig 'How Law Affects Lending' *Columbia Law and Economics Working Paper No 285* (2006); M. Safavian and S. Sharma 'When do Creditor Rights Work?' *Policy Research Working Paper No 4296* (2007).

World Banks studies.³⁹ Similar studies have also illustrated that the legal origin has an impact upon the availability of credit and creditor protection and common law jurisdictions have more tendency to lending and creditor protection than the civil law jurisdictions have.⁴⁰ Evidence gathered from these data established that facilitation of credit and access to credit are necessary in emerging markets. Similar line of arguments equally applies for developed economies where shortcomings of the law need to be eliminated in order to create a modern set of rules responsive to the needs of businesses.

The rationale of harmonisation of rules governing receivables financing can, generally, be summarised as the facilitation of credit, increasing cross border trade and enabling small and medium sized businesses in developing markets to obtain access to low cost credit. The law should be able to provide certain features in order to meet the needs of businesses effectively and that credit can be made available at low cost. From this perspective an efficient and effective secured credit law must contain certain characteristics and have objectives.⁴¹ Similar

³⁹ For further information *see generally* World Bank, 'Doing Business in 2004: Understanding Regulation' Washington DC, Oxford University Press for the WB and IFC (2004).

⁴⁰ *See generally* T. Beck, A. Demirguc-Kunt and R. Levine, 'Law and Firms' Access to Finance' *Policy Research Working Paper No 3194* (2004); T. Beck, A. Demirguc-Kunt and R. Levine, 'Law and Finance: Why Does Legal Origin Matter?' *Policy Research Working Paper No 2904* (Washington DC, World Bank, 2002).

⁴¹ These are clearly set out in the UNCITRAL Legislative Guide on Secured Transactions and include the promotion of secured credit, allowing utilization of the full value broad range of assets to support credit in the widest possible array of secured transactions, obtaining security rights in a simple and efficient manner, providing for equal treatment of diverse sources of credit and of diverse forms of secured transactions, validating security rights in assets that remain in the possession of the grantor, enhancing predictability and transparency with respect to rights serving security purposes by providing for registration of a notice in a general security rights registry, establishing clear and predictable priority rules, facilitation enforcement of creditor's rights in a

arguments equally apply to the assignment of receivables. Receivables financing by its nature involves transfer of continuous stream of receivables from the assignor to the assignee. This stream may involve both present and future receivables. However, not every legal system permits the assignment of future receivables. Assignment of future receivables is the backbone of many receivables financing transactions such as securitisation. Some jurisdictions have special legislations to allow the assignment of future receivables for securitisation practices.⁴² Other jurisdictions do not recognise the assignment of future receivables on the basis of the specificity doctrine according to which all receivables must be specifically indicated in the assignment contract at the time of the assignment and by virtue of a rather more interesting rule which has already many exceptions, the *nemo dat* rule. Further restrictions on the assignment of receivables in bulk such as the requirement of specificity and notification of debtors, as a condition of validity even as between the assignor and the assignee are significant impediments on receivables financing. Assignment of receivables in bulk is also used in factoring practices, in the context of which particularly the requirement of notification makes it an unworkable method of raising finance. Notification requirement for the effectiveness of an assignment is also a significant impediment before securitisation practices, hence the need for modernised harmonisation of the law of assignment of receivables.

The assignor should be able to use all of the suitable assets as collateral to secure any obligation. However, in some legal systems receivables or intangibles are not regarded as an

predictable and efficient manner, balancing the interests of affected persons, recognizing party autonomy and harmonizing secured transactions laws, including conflict-of-laws rules. See Guide Recommendation 1.

⁴² A. Flessner and H. Verhagen, *Assignment in European Private International Law Claims as property and the European Commission's 'Rome I Proposal'*, Munich: Sellier, 2006, at 6-7.

acceptable type of collateral. The law should also be able to permit security to be taken over both future and existing assets of the assignor. The law should protect the debtors while facilitating credit and promoting assignment practices by making law more transparent and modern. The law should also be able to ensure that the third parties can be informed about the legal status of the assignor's property (whether it is subject to a security interest or whether it is sold) and that third-party effectiveness is achieved in a transparent way. Furthermore, the law should establish clear rules of priority for assignees.

3. Background of the Receivables Convention

Harmonisation in the area of receivables financing is necessary for the facilitation of credit at lower costs, which is particularly beneficial for emerging markets, and reduces legal conflicts and costs in cross border transactions. Appropriate legal reforms may achieve modernisation and lead to economic growth. Divergence in the way national legal systems regulate taking security over or sale of receivables, which are matters deeply rooted in the cultural, legal and historical traditions of nations, increases the cost of credit, in the global markets, affects the competitiveness of businesses. Divergence in the way legal systems treat creation, third party effectiveness, priority and enforcement of a security right affects the fundamental aspects of secured transactions laws⁴³ and in the comparative perspective these differences arise out of the proprietary effects of security.⁴⁴ Particularly, the role of possession

⁴³ Report of the Secretary General: Study on Security Interests (A/CN.9/131 and Annex), *reprinted in*: 8 Yearbook of the United Nations Commission on International Trade Law, 1977, 180 *et seq.* For a similar view *see also* generally H.L. Buxbaum 'Unification of the Law Governing Secured Transactions: Progress and Prospects for Reform' *Unif. L. Rev.* 322 (2003).

⁴⁴ For a comparative analysis of cross border receivables financing *see e.g.* H.C. Sigman and E.M. Kieninger, *Cross-Border Security over Receivables*, (Sellier, Munich, 2009).

in some civil law jurisdictions as the significant element in proprietary rights⁴⁵ is considered to be an obstacle to the development of receivables financing and its harmonisation.

The differences among national secured credit legislations were established by a report prepared by Professor Ulrich Drobnig.⁴⁶ This report suggested that the harmonisation of secured transactions laws was, then, not possible due to their great divergence. It also reflected that the divergence of national laws was experienced in the fundamental aspects of security interests including formality needed to create security interests, the limited recognition of non-possessory security, unitary security over all assets of the debtor, publicity and registration. The report also suggested three methods of harmonisation of secured credit laws.⁴⁷ Following the Drobnig Report, the UNCITRAL considered two reports⁴⁸ and a study on the feasibility of uniform rules on security interests was prepared.⁴⁹ Due to reasons such as wide range of difference which are closely connected to insolvency laws and the obvious

⁴⁵ See generally R. Goode 'Reflections of the Harmonization of Commercial Law' in R. Cranston and R. Goode (eds.) (1993) *Commercial and Consumer Law National and International Dimensions* Clarendon Press, Oxford 3, at 12. For example, receivables are intangible assets which cannot be transferred using traditional methods of transfer or security.

⁴⁶ Report of the Secretary General: Study on Security Interests (A/CN.9/131 and Annex), *reprinted in*: 8 Yearbook of the United Nations Commission on International Trade Law, 1977, 171; for a recent general report prepared by Professor Drobnig see also Drobnig, U (2003) 'Present and Future of Real and Personal Security' (5) *European Review of Private Law* 623.

⁴⁷ Recommendations, model law and conventions. See *ibid* at 218.

⁴⁸ A/CN.9/130 and A/CN.9/132. These reports relate to the national systems' security interest laws and the other was related to the UCC Article 9.

⁴⁹ UNCITRAL Report on Tenth Session (1977) A/32/17, para. 37.

difficulties then existing in the harmonisation work, the study on security interests was postponed until the 1990s.⁵⁰

However, since the 1970s and ‘with the accelerating pace of market interdependency [and the recognition of] ... the importance of a sound legal regime for security interests in personal property, both for domestic and cross-border transactions’⁵¹ there has been a movement towards the harmonisation of secured transactions laws at both regional and international levels. This movement has resulted in the preparation of a number of important international instruments.⁵² Following the UNCITRAL Congress⁵³ in 1992, the UNCITRAL prepared three reports that elaborate the possibilities of the work on the assignment of receivables.⁵⁴ The UNCITRAL identified certain legal problems in receivables financing. The reports concluded that it would be both desirable and feasible to develop a set of uniform rules in order to

⁵⁰ UNCITRAL Report on Thirteenth Session (1980) A/35/17, paras. 26-28

⁵¹ See R. Goode ‘Harmonised Modernisation of the Law Governing Secured Transactions’, Outline, in *Worldwide Harmonisation of Private Law and Regional Economic Integration*, Congress for the Celebration of 75th Anniversary of Unidroit, Rome, 7, (2002).

⁵² UN Convention on the Assignment of Receivables in International Trade (2001); Unidroit Convention on International Interests in Mobile Equipment (2001); OAS Model Inter-American Law on Secured Transactions (2002) and UNCITRAL Legislative Guide on Secured Transactions.

⁵³ Uniform Commercial Law in the Twenty-First Century: Proceedings of the Congress of the United Nations Commission on International Trade Law. A/CN.9/378 Proposals for possible future work made at the UNCITRAL Congress: Note by the Secretariat Yearbook of the United Nations Commission on International Trade Law, 1993, vol. XXIV, at 227 *et seq*

⁵⁴ A/CN.9/378/Add.3; A/CN.9/397; A/CN.9/412.

remove obstacles before the international receivables financing.⁵⁵ The UNCITRAL observed that

the diversity of national laws and the lack of standard transnational rules creates significant additional expenditure, delays and uncertainty [in] many international business transactions ... [and] parties may be dissuaded from using receivables financing at all and are then forced to rely on ... more expensive arrangements, such as overdraft facilities, letters of credit or export guarantees.⁵⁶

Although the Receivables Convention has been signed by three countries and ratified by one,⁵⁷ feasibility studies as to the possibility of adoption of the Receivables Convention have been underway in North American jurisdictions.⁵⁸ It is believed that other countries will follow suit soon.⁵⁹

⁵⁵ See A/CN.9/412 *reprinted in* Yearbook of the United Nations Commission on International Trade Law, 1995, Vol. XXVI, at 228, para. 83.

⁵⁶ “UN investigates receivables financing” International Trade Finance June 3, 1994; 213 ABI/INFORM Global at 4 *et seq.*

⁵⁷ http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables_status.html (last accessed 10 May 2012)

⁵⁸ For calls urging the US to adopt the Receivables Convention *see e.g.* R. M. Kohn, *Convention to bolster exports and jobs U.N. Pact would increase business loans based on receivables* The Washington Times, 6 March 2012. *See e.g.* Uniform Law Conference of Canada http://www.ulcc.ca/en/us/Assignment_Receivables_International_Trade_En.pdf (last accessed 10 May 2012); National Conference of Commissioners on Uniform State Laws (NCCUSL) http://www.law.upenn.edu/bll/archives/ulc/aor/2007june_amreport.htm (last accessed 10 May 2012). Particularly in the United States the self-execution method of implementation may be chosen. *See*

4. General Principles of the Receivables Convention

The Convention validates assignments of future receivables and receivables assigned in bulk, and by partially invalidating contractual limitations to the assignment of receivables. Certainty is achieved with respect to the rights of the assignor and assignee, as well as with respect to the effectiveness of the assignment as against the debtor. The Convention also establishes a much debated conflict-of-laws provision on priority of competing claims. It also provides a substantive law regime as an optional annex governing priority between competing claims.

4.1 Applicability

4.1.1 Scope of Application as to Substance

The scope of application of the Receivables Convention is based on the scope of the terms ‘*assignment*’ and ‘*receivables*’. These two terms have been defined together with the terms “debtor”, “assignor” and “assignee” in article 2(a). The term ‘assignment’ encompasses assignments by way of sale and for security purposes, contractual subrogation and possessory security interests (pledge), thus the Convention adopts functional approach to receivables

http://www.uncitral.org/pdf/english/colloquia/3rdSecTrans/Ed_Smith_Implementation.pdf (last accessed 10 May 2012).

⁵⁹ See generally S. Bazinas, R. M. Kohn, L. F. del Duca, ‘Facilitating a Cost-Free Path to Economic Recovery-Implementing a Global Uniform International Receivables Financing Law’ 44 *UCC Law Journal* 277 (2012).

financing.⁶⁰ The Receivables Convention excludes unilateral assignments and transfers by operation of law such as statutory subrogation.⁶¹ The Receivables Convention does not deal with the nature of a transfer as an assignment by way of sale or security. This matter has been left to the law applicable outside the Convention.⁶² This may be a cause for concern from a harmonisation perspective as an assignment by way of sale and by way of security are distinct, and not all jurisdictions treat them in a unitary manner.⁶³ The term ‘receivable’ in general

⁶⁰ For further discussion see e.g. C. Walsh, ‘Security Interests in Receivables’ in H. Eidenmüller and E-M. Kieninger (eds) *The Future of Secured Credit in Europe* E.C.F.L.R, Munich: De Gruyter Recht, 2008, 321, 322 *et seq*

⁶¹ S. Bazinas, ‘UNCITRAL’s Contribution to the Unification of Receivables Financing Law: the United Nations Convention on the Assignment of Receivables in International Trade’ (2002) *Uniform L. Rev.* 49, at 51. It should be noted, however, that not all forms of subrogation will necessarily be by operation of law and it depends on intention see generally C. Mitchell, *Subrogation: Law and Practice*, Oxford: Oxford University Press, 2007

⁶² See Explanatory Note of the UNCITRAL Secretariat on the United Nations Convention on the Assignment of Receivables in International Trade, United Nations Publication: New York, 2004, at 29.

⁶³ E.g. Under English law assignment by way of sale and security are treated distinctly. Under s. 136 Law of Property Act 1925 the assignment must be absolute and not by way of charge. While the assignment by way of security is registered as a charge under CA 2006, sale of receivables is not registered. The Law Commission Report supported the registration of outright sales to create certainty and transparency and to reduce the cost of credit. See paras 1.12 and 2.34-2.39. Whilst an assignment by way of security may be set aside for grounds related to Insolvency Act 1986 (e.g. defrauding creditors, transactions at an undervalue), assignment by way of sale cannot be set aside except the fact where the discount may be extortionate. An assignment by way of security may be prohibited whereas an outright sale cannot be prohibited. see L.S. Sealy and RJA Hooley, *Commercial Law Text, Cases and Materials*, London: Butterworths, 3rd ed., 2003, 983. In the outright sales or factoring of receivables, the financier is concerned with the value of the receivable as opposed to the creditworthiness of the SME See generally L. Klapper, ‘The Role of Factoring for Financing Small and Medium Enterprises’ *World Bank Policy Research Working Paper* 3593 (2005). See also *Siebe Gorman & Co Ltd v Barclays Bank Ltd*. [1979] 2 Lloyd’s Law Reports 142; *Re Kent and Sussex Sawmills Ltd*. [1947] Ch. 177; *Lloyds & Scottish Finance v. Cyril Lord Carpet Sales* [1992] BCLC 609.

indicates a present or future right to payment deriving from contracts of sale or services. Receivables may arise from either commercial or consumer contracts. Receivables arising out of the rights of parties under a negotiable instrument, consumer transactions or real estate transactions, such as rents, fall within the scope of the Convention. These types of receivables constitute significant income revenues. However, under article 4(3)-(5), the Receivables Convention cannot affect the rights of certain parties to the assignment of such receivables. This is particularly important since for public policy reasons the Convention takes the position that consumer protection legislation should not be adversely affected. Similarly the Convention takes the position that State sovereignty over the immovable property should not be adversely affected. Disputes between the assignee and a person with a right over the property related to receivables arising out of immovable property are referred to the law of the State where the immovable property is located.⁶⁴ The Receivables Convention limits its scope under article 4(1) and (2), by excluding assignments of certain types of receivables and certain types of assignments. The rationale for excluding certain types of assignments is 'lack of market'.⁶⁵ These excluded assignments are made to individuals for personal, family or household use and as part of the sale or change in the ownership or legal status of the business out of which the assigned receivables arose. Thus, it is arguable that the Receivables

On the other hand, the UCC Article 9 treats assignments by way of security and by way of sale more or less the same for purposes of perfection and priorities, but differently for enforcement purposes. Filing an assignment by way of sale under UCC Article 9 does not convert this transaction into a secured transaction.

⁶⁴ See S. Bazinas, 'Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitization and Cross-Border Perfection', 12 *Duke J. Comp. & Int'l L.* 365, n.14 (2002); but cf. H. Sigman and E. Smith, 'Toward Facilitating Cross Border Secured Financing and Securitization: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade', 57 *Bus. Law.* 727, at 735-6 (2002).

⁶⁵ Explanatory Note *op cit* 62, para 11, at 30.

Convention aims to include those assignments that are related to continuous flow of receivables.

Receivables arising out of financial contracts governed by netting agreements foreign exchange transactions, deposit accounts, letter of credit or independent guarantees, inter-bank payments, receivables arising under securities⁶⁶ and transactions on a regulated exchange are excluded. These receivables are sufficiently regulated⁶⁷ and it would be futile to create an overlapping regulation.⁶⁸

4.1.2 Territorial Scope of Application

The Receivables Convention applies to international assignment of domestic receivables (international assignment connection) and to domestic assignment of international receivables (international receivable connection).⁶⁹ The Convention applies when there is an international assignment or an international receivable. Exceptionally, the Convention also applies to some

⁶⁶ Especially, the Convention excludes, by virtue of article 4(2)(e), transactions involving the assignment of receivables from securities or other financial assets or instruments held with an intermediary. For more information *see* The Report of the UNCITRAL 34th session, U.N. G.A.O.R. 56th session, Suppl. No. 17, P135, UN Doc. A/56/17 (2001).

⁶⁷ Such as letters of credit and independent guarantees that have been regulated in the international arena with the 1995 United Nations Convention on Independent Guarantees and Stand-by Letters of Credit.

⁶⁸ *See e.g.* S. Bazinas, 'Lowering the Cost of Credit: The Promise in the Future UNCITRAL Convention on Assignment of Receivables in International Trade', 9 *Tul. J. Int'l & Comp. L.* 259, at 268 (2001); Bazinas, Kohn and Del Duca, *op cit* 59, at 286 noting that assignments to a consumer under article 4(1)(a) do not occur often in practice.

⁶⁹ Article 1(1)(a).

extent, to the domestic assignment of domestic receivables.⁷⁰ The connecting factor is location of the assignor.

Internationality is based on the time of the original contract out of which the receivables arise and the time of the contract of assignment (article 3). The Receivables Convention applies to assignments that are international at the time of the conclusion of the contract of assignment or to receivables that are international at the time of the original contract. The international criterion is met when the receivables are assigned internationally or the assignment relates to international receivables. The applicability is expanded by fixing internationality on both the assignment and the receivable. An ‘*international assignment*’ is an assignment where the assignor and the assignee are located in different States, as it relates to the contract of assignment and an ‘*international receivable*’ is a receivable where the assignor and the debtor are located in different States, as it relates to the original contract.

A fictional location has traditionally been attributed to intangible property; however, this is far from satisfactory.⁷¹ The location under the Receivables Convention is the real location of the assignor where the insolvency proceedings will be commenced. The determination of the time of location under article 22 is the time of the conclusion of the contract of assignment.⁷² Ascertaining the location under the Convention will assist parties to determine the law applicable to priority and priority has no relevance to the question of who the debtor should

⁷⁰ Article 1(1)(a) and (b).

⁷¹ For discussion and criticism of attributing a situs *see e.g.* P. Rogerson, ‘The Situs of Debts in the Conflict of Laws-Illogical, Unnecessary and Misleading’ 49 *CLJ* 441, 453 *et seq.* (1990).

⁷² A/CN.9/455, paras 19 and 21

pay. This latter aspect is related to the discharge of debt and under both the Rome I Regulation article 14(2) and the Receivables Convention it is adequately protected.

The definition of the term “*location*” under article 5(h) affects both the scope of application of the Convention and the priority rule envisaged under article 22. It is defined as the place of business of a person (in the case of several places of business, the central administration)⁷³ or, in the event there is no place of business, the habitual residence of a person. In the case of multiple places of business of the debtor, the Convention’s approach is different. Location in that regard refers to the place which has the closest relationship to the relevant transaction.⁷⁴ As a result if the assignor’s central administration is located in a Contracting State, the Convention applies even to assignments made through branch offices.⁷⁵

The Convention, in principle, does not apply to domestic assignments of domestic receivables. However, there are two exceptions. The first one appears when there is a subsequent assignment under article 1(1)(b). The Receivables Convention ‘...applies to such subsequent assignments irrespective of whether the subsequent assignments are international or relate to international receivables, provided that any prior assignment in the chain of subsequent assignments is governed by the Convention.’⁷⁶ Therefore the Convention is

⁷³ See also E.M. Kieninger and H. Sigman, ‘The Rome – I Proposed Regulation and the Assignment of Receivables’, *The European Legal Forum*, 1-2006, 3

⁷⁴ Explanatory Note, *op cit* 62, para. 19, at 32. The Note suggests that the place of central administration can also be understood ‘(in other words, the principal place of business or the main centre of interests).’

⁷⁵ For further information see Explanatory Note, *op cit* 62, para 20, at 32-33.

⁷⁶ Explanatory Note, *op cit* 62, at 31, para. 15.

applicable to that domestic receivable.⁷⁷ This regulation on subsequent assignments broadens the applicability of the Convention. The second exception appears where the Convention covers all priority issues by being applicable to the conflicts between the domestic assignee of a domestic receivable and a foreign assignee of the same domestic receivable, by virtue of articles 5(m)(i) and 22. In the application of priority provisions the law of the assignor's State shall apply and govern the priority of the right of the assignee in the above alternatives

4.2 Contractual and Statutory Limitations and the Effectiveness of an assignment

The Receivables Convention removes certain contractual and statutory restrictions to assignment of receivables. Anti-assignment clauses in underlying contracts and restrictions on the assignment of future receivables and receivables assigned in bulk are significant obstacles to modern financing transactions.

4.2.1 Statutory restrictions

Article 8 aims to facilitate the flow of credit by eliminating statutory limitations in national laws. In this context, the Convention especially facilitates financing practices such as securitization, project financing and asset-based financing by recognising the effectiveness of the assignment of future receivables and receivables not identified individually. Certain legal systems restrict the assignment of future receivables and receivables assigned in bulk in order

⁷⁷ A/CN.9/489, para. 38 and also paras. 19-20. ('[I]f a receivable is domestic, its assignment may come within the ambit of the ... Convention if it is international or it is part of a chain of assignments that includes an earlier international assignment.')

to protect the assignor from over charging its assets.⁷⁸ The cost of credit is increased by describing every single receivable upon its creation and notifying the debtor for every receivable, and this difficulty is multiplied by the administrative work to ensure an effective transfer. Administrative costs arise when the assignor and the assignee create new agreements each time a receivable comes into existence.

There are certain reasons for restricting these types of assignments. One of the main reasons why States restrict assignment of future and bulk receivables is to protect ‘the assignor from excessive limitations on its economic activity, addressed by requirements for a specific description of the assigned receivable.’⁷⁹ The reasoning behind the concerns over assignments of bulk and future receivables is that these types of financing practices may have impact ‘on the economic freedom of the assignor or related specificity concerns.’⁸⁰ The restriction of security over future receivables arises out of ‘the desire to restrict security and ... the desire to prevent future property being caught up as a security for pre-existing debt.’⁸¹ Also, in some legal systems statutory prohibitions on bulk assignments have been justified with the ‘concerns about the advantage gained by [large] financing institutions, obtaining a bulk assignment ... and future receivables from their borrowers, over small suppliers, who are often protected by retention of title arrangements.’⁸²

⁷⁸ For a similar assertion see S. Bazinas, ‘Lowering the Cost of Credit: The Promise in the Future UNCITRAL Convention on Assignment of Receivables in International Trade’ 9 *Tul. J. Int’l & Comp. L.* 259, at 265 (2001).

⁷⁹ Bazinas, *ibid.*, at 265.

⁸⁰ S. Bazinas, *Multi-Jurisdictional Receivables Financing: UNCITRAL’s Impact on Securitization and Cross-Border Perfection*, 12 *Duke J. Comp. & Int’l L.* 365, 371 (2002).

⁸¹ P. Wood, *Comparative Law of Security and Guarantees* London: Sweet & Maxwell, 1995, 41.

⁸² Bazinas, *ibid.*, at 372.

Due to specificity and publicity requirements the assignability of future receivables is recognised in most jurisdictions except in traditional Napoleonic legal systems.⁸³ Specificity and publicity doctrines may not be compatible with the requirements of modern finance. The doctrine of specificity⁸⁴ may be defined as identification, specification and separation of the asset from the transferor's assets in order to be assigned.⁸⁵ This separation may either be in the form of specification of the debtor or the information on the receivable. The rationale of specification is that the owner of assets needs to be known in order for it to be transferred. Publicity and specificity are intertwined and the former depends on the latter, because publicity may require some form of creditor's control or possession over the assets and for this assets need to be specifically identified otherwise the transfer cannot be publicised.⁸⁶ Under the publicity requirement, if an assignment requires notification of the debtor whose identity may not be known at the time of the contract of assignment that may be considered as an obstacle to the assignment of future receivables. The critical problem with notification to

⁸³ K. Zweigert and H. Kötz, *An Introduction to Comparative Law* Oxford: Clarendon Press, 3rd ed., 1998, 445 *et seq.*; see also P. Wood, 'World-Wide Security – Classification of Legal Jurisdictions' in J. Norton and M. Andenas (eds) *Emerging Financial Markets and Secured Transactions* London: Kluwer, 1998, 39, 40 *et seq.*

⁸⁴ This doctrine has been abolished in England by *Tailby v. Official Receiver* (1888) L.R. 13 App. Cas. 523 and *Holroyd v. Marshall* (1861) 10 HLC 191, [1861-1873] All ER Rep 414. The doctrine has three basics. Firstly, one cannot transfer an asset unless the asset is identified. Secondly, if a security is created over a future asset at the present time to cover an existing debt, then this actually is a creation of security for pre-existing debt when the asset comes into existence and is treated as potentially voidable preference. Thirdly, there may be a prejudice against debtors granting security over all of their future receivables and thereby, either destroying their means of income or weakening the cushion available to unsecured creditors, see P. Wood, *Comparative Law of Security and Guarantees* London: Sweet & Maxwell, 1995, 40 *et seq.*

⁸⁵ P. Wood, *Maps of World Financial Law*, London: Allen & Overy LLP, 2005, 83.

⁸⁶ P. Wood, *Law and Practice of International Finance*, London: Sweet and Maxwell, 2008, 258.

underlying obligors is that it provides no means of constituting a present pledge of the future accounts of a business since there is no debtor to notify until the right to payment arises.⁸⁷

These systems require the assignor to specify each receivable before assigning it. The Receivables Convention article 8(1), recognises the effectiveness of an assignment of future receivables and receivables that are not identified individually. An assignment cannot be deemed as ineffective as against the assignor, the assignee, and the debtor or a third party just because it is an assignment of future receivables or a receivable that is not individually identified at the time of the assignment. The only condition that the Convention sets in article 8(1)(a) and (b) is that these receivables should be identified as receivables to which the assignment relates. The Convention does not need a specific description of the receivables, and the description can even be general so long as the receivables may be identified to the contract of assignment. If the parties provide general descriptions in an assignment, this will be effective as long as receivables are described in such a manner that they can be identified as receivables to which the assignment relates which means that the debtor and the amount owed should be identifiable in order for the assignments made in bulk be valid.

⁸⁷ See R. Serick, *Securities in Movables in German Law: An Outline*, Kluwer, 1990, 81-82 (where he argues that this sort of limitation as to future accounts rather than a desire to maintain secrecy is the main reason why pledges of intangibles are not generally used in German financing practice.); see also J. Rakob, 'Germany' in H.C. Sigman and E.M. Kieninger *Cross-Border Security over Tangibles*, Munich: Sellier, 2007, 63 (arguing

...the creation of a pledge over receivables requires that notice of the pledge be sent to the third party debtor. This ... made pledges unpopular-loss of possession deprives the pledgor of the chance to work with the collateral, notice to third party debtors of receivables may damage the reputation and credit of the pledgor or may confuse the debtor about who to pay to.

Article 8(1)(b) provides that assignments of future receivables are to be given effect provided that the receivables can, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates. Further, in relation to bulk assignments they should be identifiable at the time of the assignment, if they cannot be identified individually by virtue of article 8(1)(a). Once again, identification of the exact moment at which the transfer becomes effective would clarify doubts in those legal systems where bulk assignments and assignments of future receivables are not recognized due to different problems. Effectuating the assignment of future receivables as of the time of the conclusion of the original contract ‘would not compromise the rights of the assignee, since in practice credit was extended at the time when an actual transaction from which receivables might flow was concluded.’⁸⁸ It is a correct approach to give effectiveness to the assignment of future receivables as of the time of the original contract as opposed to the time of the assignment, as the assignor might assign the same receivable to another person; therefore the Convention protects the interests of the assignee and takes a step towards the facilitation of credit.⁸⁹

⁸⁸ See A/CN.9/434, para. 118.

⁸⁹ See generally B. Markell, ‘UNCITRAL’s Receivables Convention: The First Step, But not the Last’, 12 *Duke J. Comp. & Int’l L.* 401 (2002). See also A/CN.9/445, para. 224 (where it was noted that

‘[t]here was general support for the principle that a future receivable should be deemed as having been transferred at the time of the contract of assignment. It was observed that, in view of the risk that, after the conclusion of the contract of assignment, the assignor might assign the same receivables to another assignee or become insolvent, it was essential to set the time of the transfer of the assigned receivables at the time of the conclusion of the contract of assignment ... in practice, the assignee would acquire rights in future receivables only when they arose, but in legal terms the time of transfer would be deemed to be the time of the contract of assignment.’

Under article 8(2), there is no need of a new contract of assignment to be executed when there is an assignment of future receivables and the future receivable thereafter arises or is created and naturally, can be identified to the contract of assignment. The rationale is that future receivables arise after the contract of assignment therefore there is no need to have a new assignment document covering that receivable. Article 10(1) supplements the position and provides that a personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer.

4.2.2 Contractual restrictions

The Receivables Convention under article 9(1) recognises the effectiveness of an assignment made notwithstanding an anti-assignment clause.⁹⁰ The assignment made notwithstanding an anti-assignment clause will be effective as against the debtor and the third parties such as the creditors of the assignor and his trustee in bankruptcy. Effectiveness of an assignment in violation of an anti-assignment clause would not adversely affect small debtors, as ‘they do not have the bargaining power to insert anti-assignment clauses in their contracts and ... would continue paying the same bank account or post office box.’⁹¹ This approach would not affect the large debtors as they have sufficient bargaining power.⁹² The Receivables

⁹⁰ For a more detailed treatment of anti-assignment clauses under the Receivables Convention *see e.g.* O. Akseli, ‘Contractual Prohibitions on Assignment of Receivables: An English and UN Perspective’ [2009] *J.B.L.* 650

In the United States under the UCC Article 9 regime UCC §9-406(d) provides free alienability of rights to payment and that any agreement between an account debtor (*debtor*) and an assignor is ineffective.

⁹¹ A/CN.9/WG.II/WP.105, para. 83; *see also* A/CN.9/489, para. 103.

⁹² A/CN.9/WG.II/WP.105, para. 83. The Addendum to the Draft Legislative Guide on Secured Transactions paragraph 230 clearly indicates that a debtor such as a consumer may protect itself through statutory prohibitions. A/CN.9/631/Add.1.

Convention protects the assignee, under article 9(2) by providing that the breach of an anti-assignment clause by the assignor is not in itself a sufficient reason for the avoidance of the original contract by the debtor. The liability of the assignor for breach of the anti-assignment clause is preserved under the Receivables Convention; however, the debtor may not terminate the agreement on the grounds of breach of an anti-assignment clause (articles 9(2) and 10(3)). This approach prevents the debtor avoiding the contract and strengthening his bargaining power.⁹³ It is argued that the assignee is given some confidence in the outcome of the transaction. The assignor may be held liable for breach of contract of anti-assignment, but the right to compensatory damages that the debtor may have under the applicable law has been left outside the Receivables Convention.⁹⁴ Article 9(2) expressly protects a person who is not party to an agreement between the assignor and the debtor on the sole ground that he had knowledge of the agreement. In general the knowledge of the assignee of the anti-assignment clause is irrelevant and he cannot be held liable on the sole ground of his knowledge of it. There must be additional grounds to knowledge in order for the assignee to be held liable as the third party. However, knowledge may be relevant in the case of tortious liability of the assignee such as for malicious interference with advantageous relations.⁹⁵ Article 18(3) the Receivables Convention does not allow the debtor to make a claim for breach of anti-assignment clause against the assignee by way of set-off so as to defeat the assignee's demand for payment. The Contracting States are not permitted to make a declaration to override the effectiveness of the provision of free assignability. Under Article 40, a Contracting State is permitted to declare whether an assignment of a receivable owed by a governmental debtor in

⁹³ S. Bazinas, *Key Policy Issues of the United Nations Convention on the Assignment of Receivables in International Trade*, 11 Tul. J. Int'l & Comp. L. 275, at 287 (2003)

⁹⁴ A/CN.9/489, para. 99.

⁹⁵ A/CN.9/470, para. 102; *see also* A/CN.9/WG.II/WP.105, para. 85

that State will be excluded from the Convention rules that override contractual anti-assignment terms. Although the Convention overrides the effectiveness of anti-assignment clauses by virtue of article 9, this provision will have no effect on a sovereign debtor who is located in a Contracting State if that State makes a declaration by virtue of article 40 and article 9 does not apply to restrictions arising by statute or other rule of law. It could have been a better and consolidated approach had the Receivables Convention treated sovereign debtors and ordinary debtors on an equal basis and granted effectiveness to assignments made notwithstanding an anti-assignment clause between assignors and sovereign debtors.⁹⁶

4.3 Priority of Competing Claimants

The Receivables Convention regulates priority disputes through carefully designed conflict-of-laws rules and an optional annex containing substantive rules. While the conflict-of-laws rule of the Receivables Convention has received both support and criticism,⁹⁷ it is a sophisticated and potentially far-reaching rule.

The significance of having clear rules on priority disputes is that an assignee needs to know its priority position or, at least what law will determine its priority position before extending credit. Unclear priority rules carry the risk of increasing the cost of credit. The

⁹⁶ Cf. A/CN.9/466, paras. 107-115.

⁹⁷ See e.g. L. Steffens, 'The New Rule on the Assignment of rights in Rome I – The Solution to All our Proprietary Problems?-Determination of the Conflict of Laws rule in respect of the Proprietary Aspects of Assignment' 4 *E.R.P.L.* 543 (2006); A. Flessner & H. Verhagen, *Assignment in European Private International Law*, Munich: Sellier, 2006; R. Verhagen, 'Assignment in the Commission's "Rome I Proposal"' *LMCLQ* 270 (2006); Financial Markets Law Committee, Issue 121–European Commission Final Proposal for a Regulation on the Law Applicable to Contractual Obligations ("Rome I") October 2006 and April 2006.

Convention defines *priority* under article 5(g) and *competing claimant* under article 5(m). The Convention defines *priority* in a way that includes both the concept of perfection and priority of UCC Article 9.⁹⁸ In this connection, priority includes whether the claimant has a proprietary or a personal right and therefore they are not treated distinct from priority, and whether an assignment is an outright assignment or an assignment by way of security and whether the necessary requirements to render the right effective against a competing claimant have been satisfied and by virtue of that priority may mean validity. The definition of a *competing claimant* covers all potential priority conflicts.⁹⁹ The formal validity of the assignment as a condition of priority is subject to the law of the assignor's location (article 22 and 5(g)).

In many jurisdictions priority issues with respect to security rights in tangible assets are normally decided according to the *lex situs*. However, attribution of a fictional location to receivables is not feasible.¹⁰⁰ One of the main reasons for this is that the traditional *lex situs* rule is regarded as an inefficient rule and outdated particularly in the assignment of future receivables and bulk assignments.¹⁰¹ *Lex situs* does not provide clear results because at the time of the contract of assignment when the debt has not yet come into existence (as in the case of assignment of future receivables), location cannot be ascertainable. In the case of bulk assignment the *lex situs* rule will lead to the complex results according to which the assignee will be required to do extensive due diligence to ascertain the applicable law in each case.

⁹⁸ See Sigman and Smith, *op cit* 64, at 747. UCC Article 9 §9-308(a).

⁹⁹ A/CN.9/489, para. 77.

¹⁰⁰ For a criticism of attributing a *situs* to book debts see P. Rogerson, 'The Situs of Debts in the Conflict of Laws-Irlogical, Unnecessary and Misleading' 49 *CLJ* 441, 453 *et seq.* (1990).

¹⁰¹ For a similar view see M. Moshinsky, 'The Assignment of Debts in the Conflict of Laws', (1992) 108 *L.Q.R.* 591, at 610.

Furthermore, ‘there is no universal agreement on where a receivable is located.’¹⁰² Especially, in international receivables financing transactions or in bulk assignments and assignments of future receivables, parties will have to face the difficulty of determining the location of receivable in order to find the applicable substantive law and it will create unworkable results if the law governing the receivable or the law chosen by the parties apply. The law of the receivable also ‘exposes retrospective assignees to the burden of having to determine the notional *situs* of each receivable separately.’¹⁰³ The law of the assigned receivable may create acceptable results in the assignment of single receivables or financial contracts, receivables arising from securities, swap agreements, claims arising from bank accounts and foreign exchange transactions,¹⁰⁴ in the assignment of bulk receivables it proves to be burdensome for the assignee to check each document to ascertain whether the receivable is assignable.¹⁰⁵ Further, as all receivables cannot have the same situs the assignee will be forced to have due diligence for each receivable. Application of divergent laws to priority and formal validity issues causes inconvenience for the assignee. Finally, allowing party autonomy for property aspects of an assignment and to govern priority of competing assignees cannot provide correct results. This has the risk of increasing the cost of credit for assignors despite the possibility that assignees may subject credit to the selection of favourable law. The law of the assignment contract does not consider third party rights and may lead to divergent laws applicable to two competing rights. Parties with strong bargaining powers generally impose laws favourable to their interests. Thus, the law of the assignor presents workable results particularly in

¹⁰² A/CN.9/489/Add.1, para. 30.

¹⁰³ A/CN.9/489/Add.1, para. 30.

¹⁰⁴ The Receivables Convention article 4(2) excludes these transactions and receivables from their scope.

¹⁰⁵ For some suggestions and brief overview *see* Walsh, *op cit* 60, at 321.

international trade. However, there are different views in relation to the utility and efficacy of the law of the assignor location.¹⁰⁶

An assignee under the Convention's priority rule needs to comply with the priority rules of the law of the assignor's state for the purposes of perfection and priority. This causes concern in some states that require public filing system as a condition precedent to the third-party effectiveness of an assignment.¹⁰⁷ The reason for this is that some States where the assignor is located may not have a developed priority system or a public disclosure system. Once the conflict-of-laws rule leads the assignee and third parties to the law of the assignor's State, the substantive priority rules contained in the annex become crucial. One can argue that this two-step priority solution may lead to harmonisation. This is because third parties and the assignee will have, at least, the certainty that the law of the assignor's State will apply, and this law, on the substantive basis, will be either of these substantive law priority rules in the optional annex if they opted into or another one *i.e.* the substantive law of the assignor's State. The merit of the optional annex has been explained as follows: "One of the purposes of the Annex is to provide a framework for future development of such a worldwide system, [p]erhaps if a

¹⁰⁶ For a treatment of different conflict of law rules and the Rome I Regulation *see* T.C. Hartley, 'Choice of Law Regarding the Voluntary Assignment of Contractual Obligations under the Rome I Regulation' 60 *ICLQ* 29 (2011).

¹⁰⁷ *See e.g.* Report of the Committee on Foreign and Comparative Law of the Association of the Bar of the City of New York (December 21, 2001), at 10 (where it was stated "Although ... a choice of law rule, is by no means a negligible accomplishment, it is something of a disappointment for those legal practitioners and business people who operate in States which have filing systems and who were hoping to see such a system established worldwide.")

few States create an international filing system, other will be able to observe its merits in action.’¹⁰⁸

‘Location’ under the Convention ‘was considered as being the real location of the [assignor] and ...it leads to the law of the State in which the main insolvency proceedings [against the assignor] would most likely be opened.’¹⁰⁹ Professor Walsh focuses on two possible methods to define location. These are assignor’s actual centre of administration or the legal centre of assignor’s business which may be either the place under whose laws it is constituted or where it is registered.¹¹⁰ The time for the determination of location under article 22, for predictability purposes, is the time of conclusion of the contract of assignment.¹¹¹ The law of the assignor’s state where the assignor has more than one place of business will be determined at the time of the assignment and this is the place where the central administration of the assignor is exercised. The location of assignor ‘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.’¹¹²

¹⁰⁸ Report of the Committee on Foreign and Comparative Law of the Association of the Bar of the City of New York (December 21, 2001), at 10.

¹⁰⁹ Article 5(h); UNCITRAL Legislative Guide on Secured Transactions, para. 21, at 395.

¹¹⁰ C. Walsh, ‘Receivables Financing and the Conflict of Laws: The UNCITRAL Draft Convention on the Assignment of Receivables in International Trade’ 106 *Dick. L. Rev.* 159, 175 (2001).

¹¹¹ Receivables Convention article 1(1)(a) ‘...if, at the time of conclusion of the contract of assignment, the assignor is located in a Contracting State,...’ For a similar determination of time formula *see* Rome I Regulation article 19(3).

¹¹² A/CN.9/489/Add.1, para. 32.

The key advantages of article 22 is that, in the event of insolvency of the assignor, the law governing the priority and the law governing the insolvency of the assignor will be the same (*i.e.* the law of the assignor's state). Thus the applicable law will not be set aside because its application may be manifestly contrary to the public policy or mandatory rules of the forum. This article is subject to articles 23 and 24 (mandatory law and public policy exceptions and special law on priority in proceeds.) Under article 23 mandatory rules of the forum or the applicable law cannot override the law of the location of the assignor. However, in an insolvency proceeding commenced in a State other than the assignor's State, any preferential right that arises and given priority over the rights of the assignee in insolvency proceeding may be given priority notwithstanding the application of the law of the location of the assignor.

The optional annex comprises substantive law priority rules, which the Contracting States may opt into if they 'wish to modernize or to adjust their laws to accommodate assignments under the Convention.'¹¹³ The rules are based on UCC Article 9 (first registration in time), English law (*Dearle v Hall*) and Civil law system (first assignment in time). As prescribed in article 42 (4) even if a State applies its own priority rules, they can still utilise the registration system in order to benefit from the main objectives of the Convention and to create certainty in receivables financing. One of the main reasons why the Commission has prepared this optional annex is that some States may have no national priority rules, or the rules that they have may be outdated or not fully adequate in addressing all relevant problems.¹¹⁴

¹¹³ S. Bazinas, 'Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitization and Cross Border Perfection', 12 *Duke J. Comp. & Int'l L.* 365, at 380 *et seq.* (2002).

¹¹⁴ A/CN.9/489/Add.1, para. 72.

4.3.1 Priority Rules based on registration

Section 1 and 2 of the Optional Annex deals with the registration and aims to provide notice to potential financiers that certain receivables may have been assigned and it establishes priority. The rule on priority among several assignees, under Section I article 1 of the optional annex, is that the assignee that registers the data about the assignment first in order gains priority. If no such data are registered, priority will be determined by the order of conclusion of the respective contracts of assignment. The rationale underlying 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 claims.”¹¹⁵ Section I article 2 regulates the priority between the assignee and the insolvency administrator or creditors of the assignor. The main point in article 2 is that, if registration takes place and the receivable is assigned before the commencement of insolvency proceedings in relation to the assets and affairs of the assignor, the assignee will have priority. Section II article 3 sets out the details of establishment of a registration system. This is an especially important guide for Contracting States that do not have a registration system. The registry is open to any person for search of the records according to identification of the assignor and a search in writing can be obtained. The written search result issued by the registry is admissible as evidence and is proof of the registration of the data to which the search relates. The registration is proposed to be simple and inexpensive and requires a limited amount of data by virtue of article 4, which establishes the basic characteristics for an efficient system and therefore, an assignee and an assignor would not be required to register information that is too detailed. These basic characteristics are ‘the public character of the registry, the type of data that need to be registered, the ways in which the

¹¹⁵ A/CN.9/489/Add. 1, para. 74.

registration-related needs of modern financing practices may be accommodated and the time of effectiveness of registration.’¹¹⁶

4.3.2 Priority rules based on the time of the contract of assignment

Article 6 deals with priority among several assignees based on the order of the conclusion of the respective contracts of assignment. Article 7 is concerned with priority between the assignee and the insolvency administrator or creditors of the assignor. The right of the assignee has priority over the right of an insolvency administrator and creditors, provided that the receivable is assigned before the commencement of insolvency proceedings. The time of the assignment may be established by any method of proof under article 8.

The time of the assignment determines priority, although under the *nemo dat* rule, after the first assignment, the assignor cannot assign the same receivable to another assignee, because he has no right to assign. The disadvantage of this approach is that third-party creditors may be unable to determine whether certain receivables have been assigned, as there is no registration system that they can check. This may have a negative impact on the availability and the cost of credit because third-party creditors would need to cover themselves against the risk of a previous assignment having taken place. On the other hand “in a closed market, banks can still rely on borrowers’ representations and gain knowledge about their clients’ financial transactions [and] and the penalty for double financing of receivables in these markets outweighs the potential benefits.”¹¹⁷

¹¹⁶ A/CN.9/489/Add. 1, para. 78.

¹¹⁷ Bazinas, 79, at 284.

4.3.3 Priority rules based on the time of notification of assignment

Priority is determined by the order in which the debtor receives notifications of the respective assignments. However, the knowledge of a prior assignment by an assignee makes it impossible for that assignee to obtain priority over that prior assignment even if the subsequent assignee notified the debtor first. With respect to priority between the assignee and the insolvency administrator or creditors of the assignor article 10 introduces a similar approach to that followed in other articles in the Annex. According to article 10, the assignee has priority over the right of an insolvency administrator if the receivable was assigned and notification was received by the debtor before the commencement of such insolvency proceeding. It is arguable that in this system potential assignees may inquire from the debtor, whose accurate and immediate response is vital, whether prior to them certain receivables have been assigned. Also, in the assignments of bulk and future receivables the system may not respond to the needs of potential assignees, as the identity of the debtor will be unknown or there will simply be multiple debtors. Therefore, it may be very costly for assignees to find out whether certain receivables have been assigned.¹¹⁸

For instance, in England there is fragmentation of the law in this area. An assignment made by a company will only be registrable, if it is an assignment by way of security over book debts.¹¹⁹ If it is an assignment by way of sale it is not registrable. On the other hand, all types of assignments (outright or for security purposes) by an individual are registrable.¹²⁰ The Law

¹¹⁸ For the criticism of the rule in *Dearle v. Hall* see e.g. J. de Lacy, 'The Priority Rule of *Dearle v. Hall* Restated', (1999) 63 *Conv.* 311.

¹¹⁹ CA 2006, s.860(7)(f).

¹²⁰ Insolvency Act 1986, s.344.

Commission in its Report recommended that sale of receivables by companies should also be registered.¹²¹ The issue has wider implications. As functionally sale of receivables is similar to charge over receivables, it seems perfectly reasonable to make the sale of receivables registrable. Lack of registration causes certain problems such as subsequent creditors or assignees have to rely on the representations of the assignor and may not be informed of the existence of a functional equivalent of charge over receivables.¹²² What is more striking is that the rule in *Dearle v Hall*,¹²³ which regulates priority over receivables, is outdated. It is not suitable for modern financing techniques. Take as an example of assignment of bulk receivables: it seems almost impossible to notify each debtor, to fulfil the requirements of *Dearle v Hall*.¹²⁴ Failure to notify debtors will result in the loss of priority status in subsequent assignment under *Dearle v Hall* and in civil law jurisdictions the assignment becomes void in the insolvency of the assignor.¹²⁵ It is arguable that this is because of formal validity and publicity requirements are considered as condition of priority and they have not been met. Professor Oditah succinctly explains the danger of application of this outdated rule to assignment of bulk receivables as follows:

¹²¹ Law Commission Report No. 296, para. 4.7 *et seq.*

¹²² *Ibid.*

¹²³ (1828) 3 Russ I.

¹²⁴ Nevertheless, the rule also applies to assignment of bulk receivables *Compaq Computer Ltd. v. Abercorn Group Ltd.* [1993] BCLC 602.

¹²⁵ For a similar assertion see F. Oditah, 'Recurrent Issues in Receivables Financing' in J. Armour and J. Payne *Rationality in Company Law Essays in Honour of DD Prentice* Oxford: Hart, 2009, 321, at 351.

... bulk assignees of receivables, especially lenders as opposed to invoice discounters generally do not give notice of their bulk assignments until the assignor defaults and it is necessary for the assignee to collect the assigned receivables itself.¹²⁶

In the assignment of future receivables the rule does not produce any logical results. It is not possible to notify debtors who are unknown at the time of conclusion of the contract of assignment. However, even when the identities of future debtors are known (all my future rights of payment from XYZ Ltd. arising from the sale of aluminium wheels) and notice is given prior to coming into existence of receivables, this may not be sufficient to secure its priority, because a notice given to the debtor after the receivables have come into existence will have priority.¹²⁷

The risk that the rule in *Dearle v Hall* offers in both assignments of bulk and future receivables is self-explanatory. The cost of credit obviously will increase and for small businesses factoring or other types of financing will become increasingly difficult. Thus registration of sale of receivables to give notice to other assignees particularly in the assignment of future and bulk receivables seems to be necessary. Registration will prevent later assignees to give notice under *Dearle v Hall*¹²⁸ and obtain priority. This may, arguably, lift difficulties before the assignment of bulk receivables.

4.3.4 Independent conflict-of-laws rules

¹²⁶ *Ibid.*

¹²⁷ *Re Dallas* [1904] 2 Ch 385.

¹²⁸ The second limb of the rule under *Dearle v Hall* requires that the subsequent assignee to have no information of the existence of an earlier assignee and to give notice.

The Convention also contains independent conflict of laws rules for priorities apart from the normal conflict of laws rules for priorities prescribed in article 22. Article 30 prescribes the independent conflict of laws rules for priorities based on the law of the assignor's location and it applies to transactions to which article 22 does not apply due to absence of territorial connection.¹²⁹ Although the law applicable to priority is governed by the conflict of laws rule under article 22, the significance of article 30 is that it enables the application of the Convention to transactions which may not normally fall within the ambit of the Convention due to lack of territorial connection. The assignor does not have to be located in a contracting State for the application of the Convention. This, arguably, enables assignors to enjoy the value of the Convention in those States that prefer not to adopt the Convention.

The scope of application of article 30 is reiterated in article 1(4) according to which the provisions of Chapter V, where article 30 is located, apply to assignments of international receivables and to international assignments of receivables independently of paragraphs 1 and 2. Article 1(1) and (2) set out the applicability of the Convention and according to these paragraphs the Convention applies to assignments of international receivables and to international assignments of receivables if, at the time of the conclusion of the contract of assignment, the assignor is located in a contracting State and subsequent assignments are governed by the Convention. Since article 30 regulates the priority issues even if the assignor's State is not a contracting State, the applicability of the priority issues is enlarged.

¹²⁹ Some writers define this type of application of priority rules contained in article 30 as "indirect application through the conflicts of laws provisions of the Convention" Bruce A. Markell & Richard F. Broude, *A Short Introduction to the Priority Provisions of the UNCITRAL Convention on the Assignment of Receivables in International Trade*, (2003) 16 *Insol. Int.* 1, at 2.

However, in the second sentence of article 1(4) it is noted that those provisions do not apply if a State makes a declaration under article 39. Therefore, if a State declares that it will not be bound by the provisions of Chapter V, then the law of assignor's State shall not govern priority issues if the State of the assignor is not a Contracting State. The same goal is confirmed in article 26(a).

5. Conclusions

The Receivables Convention is a substantive step forward in the direction of the harmonisation of receivables financing laws. By virtue of its sophisticated, flexible and far reaching solutions on many issues it will be a production model for future work in the area of receivables financing and generally an acceptable text in commercial and financial life.

While the Convention has not been widely implemented yet, many of its principles have been implemented in national laws.¹³⁰ This has been done in two ways. First, States directly implemented principles of the Convention in their domestic law; and second, States that have implemented a secured transactions law that is consistent with the recommendations of the UNCITRAL Secured Transactions Legislative Guide have essentially implemented the principles of the Convention in their domestic law.¹³¹

¹³⁰ See generally e.g. Sigman and Kieninger, *op cit* 44.

¹³¹ For the general principles and efficacy of the UNCITRAL Legislative Guide on Secured Transactions see Chapter by S. Bazinas on The utility and the efficacy of the UNCITRAL Legislative Guide on Secured Transactions [000]

Reforming the law in line with the Receivables Convention will assist small firms to be able to access to credit.¹³² The solution provided for by the Convention on priority issues through offering an optional substantive annex and a conflict of laws rule creates a predictable and workable solution in cross border assignment transactions. The Convention's rules on priorities will create certainty and predictability particularly for the financiers who make lending decisions based on how the law efficiently protects their interests in case of debtor default and whether they can ascertain this fact in advance of their credit agreements. Recognising the effectiveness of the assignment of bulk and future receivables through the Convention's rules will enable small firms to be able to utilise the value of their expectant assets.

Arguably the Receivables Convention, among many of its modern features, has certain aspects that will help reduce the cost of credit and facilitate access to credit. This is particularly important for the financiers as the Convention while aiming to achieve confidence of financiers in the market establishes predictability in the law. Firstly, it sets aside statutory restrictions that limit small businesses to access to credit. Requirements that make assignability impossible in future and bulk receivables are set aside. Priority status of an assignee may not be adversely affected just because an assignment of future receivables is made. Furthermore, notification requirement to the debtor is irrelevant and this is also not a requirement under the Convention. Specificity requirement in certain jurisdictions restrict the assignability bulk receivables and future receivables. As long as the receivable is identifiable and relates to the assignment, this will be sufficient. Secondly, priority of competing claimants is subject to a single and predictable conflict-of-laws rule. The law of the assignor's

¹³² For the availability of credit and problems with money and debt *see* Chapter by D. Bholat on Money, Bank Debt and Business Cycles: Between Economic Development and Financial Crises [000]

location achieves consistency and predictability in assignment of receivables transactions. Some commentators argue that this conflict-of-laws rule may not be conveniently applicable in securitisation transactions¹³³ as the assignor's change of location may cause change of priority rules thus the debtor may not receive good discharge. However, when critically reviewed, debtor's discharge seems irrelevant in the context of the applicability of the law of the assignor's State to priority disputes. The argument does not concern priority but rather concerns debtor's discharge.

Finally, article 42(4) of the Convention suggests the creation of a registration system. As the Convention both covers assignment by way of sale and by way of security, this corresponds to the recommendations made by the Law Commission in its Report. Registration of sale of receivables will enable predictability. Furthermore, this argument may be complemented by the work of the UNCITRAL's Legislative Text on registration of security interests.¹³⁴ This is a timely decision as the Law Commission's past experience may be extremely helpful.

¹³³ J. Perkins, 'A Question of Priorities: Choice of Law and Proprietary Aspects of the Assignment of Debts' 2 *L. & F.M.R.* 238, at 240 (2008).

¹³⁴ A/CN.9/WG.VI/WP.50, Add.1 and Add. 2