



Continuing Education

The Future of International Receivables Financing: The UNCITRAL Convention on the Assignment of Receivables in International Trade--We are not alone?

Date: **Wednesday, January 15, 2003**

MODERATOR: David Morse, Otterbourg, Steindler, Houston & Rosen P.C.

PANELISTS:

Edwin E. Smith, Bingham McCutchen LLP

Neil B. Cohen, Brooklyn Law School

MATERIALS

The UNCITRAL Convention on the Assignment of Receivables in International Trade: We are not alone ...

Highlights UNCITRAL Convention on the Assignment of Receivables in International Trade

Everyone knows that the world is getting smaller...even secured lending lawyers.

Lenders are increasingly looking to their counsel to have some familiarity with the legal issues that arise in financing companies a their assets outside of the United States. With lenders more frequently looking beyond domestic shores, there has been a significant increase in the scope and intensity of the activities of international legal organizations in developing "conventions", "model laws" and "legislative guides" that may affect secured lenders.

There is even talk that some of these international conventions may be introduced in the next session of Congress, including possibly, among others, the United Nations? Convention on Assignment of Receivables in International Trade.

If Congress were in fact to ratify and adopt this Convention, would you know what to do? Would you know how it might affect your lending clients?

Join experts Ed Smith and Neil Cohen, in a panel discussion moderated by David Morse, on some of the basic principles of the Convention and how they would work in the context of specific examples for a US lender dealing with borrowers and assets located outside the United States. This is a unique opportunity to hear from those involved in the drafting of the Convention how it would really work for you.

All materials are in PDF format (requires Adobe Acrobat Reader, which may be downloaded at no charge from <http://www.adobe.com>)

Edwin E. Smith is a partner in the Boston office of Bingham McCutchen LLP where he chairs the firm's finance-related area. Ed has taught at Boston University Law School, Suffolk Law School and has served as a lecturer in secured transactions on the faculty of Harvard Law School. He is a Uniform Law Commissioner for the Commonwealth of Massachusetts, and has served as a member of the drafting committees for the 1995 revisions of Article 5 and the 1997 revisions of Article 9, as well as other parts of the Uniform Commercial Code. Ed was a U.S. delegate to the United Nations Commission on International Trade Law (UNCITRAL) in the drafting of the Convention on Assignment of Receivables in International Trade. Ed is also President of the American College of Commercial Finance Lawyers.

Neil B. Cohen is a professor of law at Brooklyn Law School. Professor Cohen was on the drafting committee for the revisions to Article 9 of the Uniform Commercial Code and chaired the committee's task force on international secured transactions. He is currently a member of the drafting committee revising Articles 2 and 2A of the Uniform Commercial Code. He also serves as the director of research for the Permanent Editorial Board of the UCC. Neil was also the reporter for the drafting committee revising Article 1 of the UCC. Neil served with Ed as a member of the United States delegation to UNCITRAL for the drafting of the Convention on the Assignment of Receivables in International Trade. He is a regent of the American College of Commercial Finance Lawyers and a member of the American Law Institute. He is a co-author of the monthly Commercial Law Report and a bi-monthly columnist on secured transactions for the New York Law Journal.

David W. Morse is a partner at Otterbourg, Steindler, Houston & Rosen, P.C. in New York. David is a member of the Executive Board of the Association of Commercial Finance Attorneys and a member of the Commercial Finance Association Education Foundation Governance Board as well as the Commercial Financial Services Subcommittee of the American Bar Association and a fellow of the American College of Commercial Finance Lawyers. He has participated in and moderated panels for ACFA and the New York Chapter of the Commercial Finance Association and has been on panels sponsored by the Practising Law Institute, as well as an instructor for the Commercial Finance Association's Advanced Legal Issues Workshop. David also participated in a colloquium sponsored by UNCITRAL in connection with secured transaction issues as part of the efforts of the current working group for UNCITRAL's legislative guide for secured transactions.

The New York State Continuing Legal Education Board certified ACFA as an Accredited Provider of continuing legal education in the State of New York and, accordingly, members of ACFA attending this meeting

will be eligible for CLE credit. Members admitted in other jurisdictions with CLE requirement should consult with the appropriate bar organization for that jurisdiction.

©2000 - 2003 The Association of Commercial Finance Attorneys Inc., All Rights Reserved.

ASSOCIATION OF COMMERCIAL FINANCE ATTORNEYS

The UNCITRAL Convention on the Assignment of Receivables in International Trade:

We are not alone....

A. Introduction

1. General:

- (a) For years as American lawyers we were able to basically ignore the laws of our countries in our practice in the secured lending arena. Lately, over the past few years it has become more common to come across transactions where clients are asking questions about the laws of other countries and the feasibility of providing US style asset-based lending either to companies in other countries or based on assets existing or arising from other countries. Beginning with Canada and the UK and now branching further afield, particularly as to the countries in the European Union, we are encountering the laws of these other jurisdictions.
- (b) The next step in this progression toward an increasingly international view of the secured lending practice, is to be aware of the various efforts of the United Nations and other international organizations to develop "conventions", model laws, legislative guides and conduct studies.

2. International Initiatives:

(a) Background:

- (i) Some of the international organizations that you may hear about in this area include:

(A) United Nations Commission on International Trade Law or "UNCITRAL";

(B) the International Institute for the Unification of Private Law or "UNIDROIT";

(C) the Organization of American States or the "OAS";

(D) EBRD;

(E) the Hague Conference on Private International Law.

- (ii) The principal tools of these organizations for "international law" consist of:

- (A) the "Convention", which is an actual statute, that must be adopted by a country, or as they are often referred to in this "States" or "Contracting States";
- (B) the "Model Law", which is similar in concept to the Uniform Commercial Code as developed by NCCUSL or the ALI which then becomes a model law for the various state legislatures; and
- (C) the "Legislative Guide" which is basically an organized set of principles designed to educate and inform legislators in countries about the issues, how they might be addressed, the alternatives available and a recommendation about how to address the issues.

(b) Activities: Some of the relatively current activities of the various international organizations include, among others:

- (i) The UNCITRAL proposed Convention on Assignment of Receivables in International Trade that was adopted by UNCITRAL in July 2001 and on December 12, 2001 by the UN General Assembly and has been recommended by the ABA that the US sign and ratify the Convention.
- (ii) The UNCITRAL Model Law on Cross Border Insolvency [details to be added]
- (iii) The UNCITRAL Legislative Guide for Secured Transactions Law;
- (iv) The UNIDROIT Convention on International Interests in Mobile Equipment and the Protocol on Matters Specific to Aircraft Equipment, adopted by a diplomatic conference in Cape Town from October 29, 2001 through November 16, 2001.
- (v) CIDIP-VI, which is the Inter-American Conference on Private International Law ("CIDIP") that is sponsored by the Organization of American States, approved a Model Inter-American Law on Secured Transactions among other things at a conference from February 4 to 8, 2002;
- (vi) The Special Commission on General Affairs and Policy of the Hague Conference on Private International Law has a provisional version of the "Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary".

3. UNCITRAL Receivables Convention:

- (a) Relevance: While all of these various organizations and projects keep scholars and academics and diplomats very busy, most of them ultimately do not have any significant

impact on our quotidian existence in the practice of secured lending law. An interesting exception to this rule arose in the Usinor case...

- (b) Legislative Status: But at this point in time, there is one possible exception to the general rule that those of us in the trenches will not be affected by the grand schemes of scholars and academicians: that is the UNCITRAL Convention on Assignment of Receivables.
 - (i) The ABA has recommended that the United States sign and ratify the Convention.
 - (ii) The Commercial Finance Association was very active in its development and has its legislative director involved in its presentation before the US Congress.
 - (iii) The Convention covers a "core" aspect of our secured lending client's businesses: getting a perfected security interest in receivables.
 - (iv) There have been discussions with the US State Department representative responsible for such matters about how to get it introduced to Congress.
 - (v) Ultimately, this Convention may be one that is ultimately adopted by the United States.
 - (vi) And, of course, if adopted by the United States, so that it becomes, as it were the "law of the land", the assumption is that other countries are likely to be influenced by the United States and follow suit. Note: Need for 5 states in order for it to be effective. Open for signature by countries for a period of 2 years.

4. Overview of Presentation:

- (a) Format: So with that introduction, we are going to focus on certain aspects of the UNCITRAL Convention on the Assignment of Receivables and try to set out how certain aspects of it might work in the context of the type of asset based financing that most of our clients do. We will try to describe generally one of the basic principles of the Convention and then try to provide an illustration as to how that principle might look in the context of a specific set of facts.
- (b) Principles:
 - (i) Scope
 - (ii) Rights between Secured Party and Debtor
 - (iii) Rights of the Account Debtors

(iv) Perfection, Priority and Other Third Party Rights

B. Scope

1. Principle: Internationality:

- (a) Convention only applies if either the “assignment” or the assigned receivable is “international”.
 - (i) International Assignment: Debtor and Secured Party are “located” in different countries OR
 - (ii) International Receivable: Debtor and Account Debtor are “located” in different countries
- (b) How is “location” determined for this purpose?
- (c) Requirement of Nexus to Contracting State: Assignor must be located in Contracting State (Article 2(a))
- (d) Definition of “Assignment”
- (e) Definition of “Receivables”
- (f) Exclusions

2. Illustrations:

- (a) US borrower incorporated in Delaware with its chief executive office in New York. Lender is a Delaware corporation with its chief executive office in New York. US is a “Contracting State”—i.e. has adopted the Convention. The borrower is giving the lender a security interest in all of its accounts, including accounts owing by account debtors located in the US, Netherlands, Germany and UK, of which the Netherlands and Germany have adopted the Convention. The UK has not adopted the Convention. The collateral also includes a tax refund from Germany and a commercial tort claim under Dutch law. Does the Convention apply and if so how?
- (b) A borrower has its chief executive office in Switzerland, but is incorporated in the US. The Lender is a Delaware corporation. The US is a Contracting State (i.e. has adopted the Convention). The borrower is giving the lender a security interest in all of its accounts, including those owing by account debtors located in the US and those located

in Switzerland and Germany.

C. Rights between Secured Party and Debtor

1. Principles:

- (a) Form of Security Agreement
- (b) Bulk Assignments
- (c) Assignments of Future Receivables
- (d) Anti-Assignment Clauses
- (e) Supporting Obligations and Liens
- (f) Assignor's Representations

2. Illustration:

- (a) US lender is financing a US company with a subsidiary in the Netherlands. The US company has asked that the US lender provide secured financing to its Dutch subsidiary. Under Dutch law, while there is a non-disclosed pledge of receivables, there is no notice to the account debtors, but there it is customary to have a notarial deed with respect to a pledge of receivables. It is also required that the receivable be specifically identified and a list of the receivables filed with a division of the Dutch tax authority. What kind of agreement is required under the Convention? Is a notarial deed required? Is the agreement effective even if under Dutch law the receivables must be specifically identified in the lists filed with the Dutch tax authority in order for the pledge to be effective? What is under Dutch law a receivable is only deemed reasonably identified if the invoice number or equivalent is listed as part of the agreement? (See Article 8(1)) Under Dutch law a pledgee that notifies account debtors even if it is subsequent to the grant of a pledge to a pledgee who has not notified account debtors, will have priority. If the Netherlands has adopted the Convention will this be the same? If the Netherlands has not adopted the Convention but the debtor is a US party and the account debtors are in the Netherlands will this still be the same?
- (b) The customers of the Dutch subsidiary typically include clauses prohibiting the assignment of the receivables in their purchase orders. What issues does the lender confront? If the Netherlands has adopted the Convention, will such prohibition be enforceable? What if the Netherlands has not? Will the lender be liable for interfering

with the agreement between the Dutch subsidiary and the customer?

D. Rights of Account Debtors

1. Principles:

(a) Notification of Account Debtor

- (i) As the parties agree
- (ii) Notification sent by Secured Party in breach of agreement is effective
- (iii) Notification is defined to require:
 - (A) a writing
 - (B) that reasonably identifies the assigned receivable and the assignee
 - (C) language the same as language of the original contract between account debtor and debtor.

(b) Discharge of Account Debtor on Assigned Account

- (i) After notification of assignment and instruction to make payment to secured party, account debtor is discharged by paying assignee.
- (ii) Account debtor is entitled to "adequate proof" of the assignment and all prior assignments; failure to provide means account debtor is entitled to discharge by paying as if notification had not been received.
- (iii) If more than one payment instruction received by account debtor, account debtor is discharged by complying with the last payment instruction received.

(c) Recoupment and Setoff

(d) Agreements not to Assert Claims or Defenses

(e) Effect of Contract Modification

(f) Secured Party Liability to Account Debtor

2. Illustrations:

- (a) The US company wants to include the receivables of its Dutch subsidiary in the borrowing base. The US lender is concerned about its ability to collect the receivables of the Dutch subsidiary. Account debtors are located in the Netherlands which has adopted the Convention and in Germany which has not adopted the Convention.

HIGHLIGHTS OF THE UNITED NATIONS CONVENTION ON THE ASSIGNMENT OF RECEIVABLES IN INTERNATIONAL TRADE

Edwin E. Smith
Bingham McCutchen LLP

January 4, 2003

On December 12, 2001, the United Nations General Assembly approved an international convention providing uniform rules on the assignments of receivables. The Convention is now being presented to States for signature and ratification. The following is a brief description some of the highlights 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 certain 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.,

^{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 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 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 other claimants 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 depository 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.