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Coordination of work: activities of international organizations in the area of security interests

Note by the Secretariat

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* Submission of this note was delayed because of the need to complete consultations with the relevant organizations.



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I. Introduction

1. The Commission, at its fourteenth session, decided that to further strengthen the coordinating role of the Commission, the Secretariat should select, at appropriate intervals, a particular area for consideration and should submit a report on the work of other organizations in that area.¹ Last year, the Secretariat selected the law of procurement of goods, construction and services for such a discussion by the Commission (see A/CN.9/539 and Add.1). This year the area selected is security interests.
2. The purpose of this paper is to provide and disseminate information on the activities of international organizations in respect of security interests with a view to facilitating coordination of current activities of various organizations and clarifying the relationship among completed texts.

II. Current activities of international and regional organizations in the area of security interests

A. UNCITRAL

1. The United Nations Convention on the Assignment of Receivables in International Trade

3. In 2001, the General Assembly of the United Nations adopted the United Nations Convention on the Assignment of Receivables in International Trade (hereinafter referred to as “the United Nations Assignment Convention”). The United Nations Assignment Convention removes legal obstacles to the assignment of receivables, provides a uniform set of rules with respect to the rights of the debtor and contains a set of uniform conflict-of-laws rules with respect to the law applicable to the effectiveness of an assignment as against third parties and to priority disputes.

2. The UNCITRAL draft legislative guide on secured transactions

4. At its thirty-fourth session in 2001, the Commission decided to entrust a working group with the task of developing “an efficient legal regime for security rights ...”.² Working Group VI proceeded with its work on the assumption that security interests in trade receivables will be covered in the legislative guide being prepared. Thus, the question arises of the relationship between the Convention and the legislative guide.

5. To the extent that the United Nations Assignment Convention addresses an issue, the recommendations contained in the legislative guide will be based on the principles codified in the Convention. To the extent that the United Nations Assignment Convention does not address an issue, the recommendations in the legislative guide will supplement the Convention. To the extent that the United Nations Assignment Convention addresses an issue only by way of conflict-of-laws rules, the recommendations in the legislative guide will support the application of the Convention in the sense that they will provide the substantive law to which the Convention refers. In particular, with respect to the law applicable to the steps

required to make an assignment effective against third parties and the priority of that assignment, which the Convention refers to the law of the assignor's location (see art. 22), the recommendations will be designed to provide the applicable substantive law priority rules. Yet States adopting domestic legislation based on the recommendations of the legislative guide will still need to adopt the Convention since the Convention provides a higher level of uniformity.

B. UNIDROIT

1. The UNIDROIT Convention on International Factoring

6. The International Institute for the Unification of Private Law (UNIDROIT) completed in 1988 the UNIDROIT Convention on International Factoring (hereinafter referred to as “the UNIDROIT Factoring Convention”). While the United Nations Assignment Convention builds on the UNIDROIT Factoring Convention, the two conventions have a different scope of application and address different issues. However, the two conventions may apply to the same factoring contract and lead to different results. For this reason, article 38, paragraph 2, of the United Nations Assignment Convention specifically provides that, in the case of such a conflict, the United Nations Assignment Convention will prevail over the UNIDROIT Factoring Convention. To avoid leaving any doubt, article 38, paragraph 2, of the United Nations Assignment Convention, states also the obvious, namely that if the United Nations Assignment Convention does not apply to the rights and obligations of a debtor (because the debtor is not located in a State party to the United Nations Assignment Convention or the law governing the contract from which the assigned receivables arise is not the law of a State party to the United Nations Assignment Convention), it does not affect the application of the UNIDROIT Factoring Convention.

2. The Convention on International Interests in Mobile Equipment

7. In 2001, UNIDROIT and the International Civil Aviation Organization (ICAO) completed the Convention on International Interests in Mobile Equipment (hereinafter “the Mobile Equipment Convention”) and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft (hereinafter referred to as “the Aircraft Protocol”). The Mobile Equipment Convention and the Aircraft Protocol may apply to the assignment of associated rights, including receivables secured by or associated with the equipment covered by the Mobile Equipment Convention and its Protocols (see arts. 1 (c) and 31). Thus, the United Nations Assignment Convention and the Mobile Equipment Convention and its Protocols may apply to the same transaction and lead to different results. For this reason, article 38, paragraph 1, of the United Nations Assignment Convention provides that it “does not prevail over any international agreement that has already been entered or may be entered into and that specifically governs a transaction otherwise governed by this Convention”. For the same reason, article 45 bis of the Mobile Equipment Convention provides that that Convention shall prevail over the United Nations Assignment Convention “as it relates to the assignment of receivables which are associated rights related to international interests in aircraft objects, railway rolling stock and space assets”.³

8. The relationship between the Mobile Equipment Convention and the Aircraft Protocol on the one hand and domestic law enacted on the basis of the recommendations of the UNCITRAL draft legislative guide on secured transactions is the same as the relationship between those texts and any domestic secured transactions law. While the Convention and the Protocol do not exclude the creation of security rights under national law, the international interest they create will usually give the creditor stronger rights than a purely domestic interest.⁴

3. The UNIDROIT draft rules regarding securities held with an intermediary

9. In 2001, UNIDROIT set up a Study Group for the preparation of harmonized substantive rules regarding securities held with an intermediary. At its fourth session, held in March 2004, the Study Group considered a draft convention. The text that will emerge from the work of UNIDROIT will not be in conflict with the United Nations Assignment Convention, since the United Nations Assignment Convention provides that the assignment of receivables arising from securities is excluded from its scope (see art. 4, para. 2 (e)). Similarly, this text should not create conflicts with the recommendations to be included in the legislative guide on secured transactions being prepared by UNCITRAL since security rights in securities are excluded from the scope of the guide. The treatment of proceeds other than securities remains to be discussed in the context of the UNIDROIT text. Similarly, the treatment of securities as proceeds (or as part of a security interest in all assets of a debtor) needs to be discussed in the context of the UNCITRAL legislative guide.

C. Hague Conference on Private International Law

10. In 2002, the Hague Conference on Private International Law completed the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary. There can be no conflict between this text and the United Nations Assignment Convention as the latter excludes from its scope the assignment of receivables arising from securities (see art. 4, para. 2 (e)). For the same reason, there can be no conflict between this text and the legislative guide currently being prepared by UNCITRAL (as to the issue of securities as proceeds or part of a security interest in all assets of a debtor, see para. 9 ad finem).

D. European Bank for Reconstruction and Development

11. In 1994, the European Bank for Reconstruction and Development (EBRD) prepared a Model Law on Secured Transactions.⁵ In 1997, EBRD prepared a set of ten Core Principles for modern secured transactions legislation.⁶ These principles form the basis for assessing a country's secured transactions law and for identifying the need for reform. Currently, EBRD is considering a set of guiding principles on security interests registries. EBRD also provides technical assistance to countries within its region for legal and institutional reform in the area of secured transactions. The future UNCITRAL legislative guide on secured transactions is expected to take into account and build on the EBRD Model Law, Principles and the guide on security interests registries.

E. Asian Development Bank

12. In 2000, the Asian Development Bank (ADB) published a guide on Secured Transactions Law Reform in Asia.⁷ In 2002, the ADB published a Guide to Movables Registries.⁸ The future UNCITRAL legislative guide on secured transactions is expected to take into account and build on those publications.

F. Organization of American States

13. In 2002, the Organization of American States prepared the Model Inter-American Law on Secured Transactions.⁹ The future UNCITRAL legislative guide on secured transactions is expected to take into account and build on this model law.

G. World Bank

14. The World Bank is currently preparing a document entitled “Principles and Guidelines for Effective Insolvency and Creditor Rights Systems”. This document deals with insolvency and secured transactions issues. It is expected that this document, together with the UNCITRAL guide on insolvency law and the UNCITRAL guide on secured transactions, once completed, will form a unified standard for insolvency and creditor rights.

H. European Union

1. The Convention on the Law Applicable to Contractual Obligations

15. The Convention on the Law Applicable to Contractual Obligations, opened for signature in Rome on 19 June 1980 (hereinafter referred to as “the Rome Convention”) deals also with the law applicable to assignments. Under article 12.1, the law applying to the contract between the assignor and the assignee under the Rome Convention governs the “mutual obligations of assignor and assignee under a voluntary assignment of a right against another person”. This law is the law chosen by the parties and, in the absence of a choice, the law of the country with which the contract is most closely connected (i.e. in the case of an outright assignment, the assignor’s country, and, in the case of an assignment by way of security, the assignee’s country (see arts. 3, 4.2 and 4.5 of the Rome Convention)).

16. Under article 12.2, the law governing the assigned right “shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor’s obligations have been discharged”. This law is the law governing the contract from which the assigned right arises (i.e. the contract between the assignor and the debtor), namely the law chosen by the assignor and the debtor or, in the absence of choice, the law of the country with which that contract is most closely connected (e.g. in the case of a sales contract, the law of the seller/assignor).

17. Articles 28 and 29 of the United Nations Assignment Convention are almost identical with article 12 of the Rome Convention. Articles 22 and 30 of the United

Nations Assignment Convention deal with the law applicable to the steps necessary to make an assignment effective against third parties and to conflicts of priority among claimants with a competing interest in the assigned receivables. Those articles may differ from article 12 of the Rome Convention, to the extent the Rome Convention addresses third-party effects of assignments. This matter is not clear, as there is a divergence of opinion in literature and practice as to whether article 12 of the Rome Convention applies to third-party effects. According to the prevailing view, article 12 does not address such issues. According to the minority view, article 12 deals also with third-party effects of assignments. This view is split though as to which law should apply, the law governing the assignment contract (art. 12.1) or the law governing the contract from which the assigned right arises (art. 12.2).

18. Articles 28 to 30 of the United Nations Assignment Convention along with other autonomous conflict-of-laws rules contained in chapter V of the Convention are subject to an opt-out by States. So, States parties to the Rome Convention that wish to ratify or accede to the United Nations Assignment Convention may enter a declaration that they will not be bound by those articles. However, article 22 of the United Nations Assignment Convention is not subject to a declaration as it reflects one of the most fundamental principles of the Convention (i.e. that priority is subject to the law of the assignor's central administration or habitual residence).

19. If article 12 of the Rome Convention is viewed as addressing the issue of the law applicable to third-party effects and applies to a transaction covered by the United Nations Assignment Convention, a conflict would arise since the two conventions would refer priority issues to different laws. Article 38, paragraph 1, of the United Nations Assignment Convention addresses such conflicts between conventions by deferring to a convention "that specifically governs a transaction otherwise governed by this Convention". So, the Rome Convention should not prevail over the United Nations Assignment Convention to the extent it is considered as dealing with contractual obligations in general and not specifically with assignments. However, the Rome Convention (art. 21) contains a similar provision and this might raise some doubt as to which convention prevails in the case of conflict.

2. The European Commission Green Paper on the conversion of the Rome Convention into a Community instrument and its modernization

20. The European Commission (hereinafter referred to as "the EC") is currently considering revising the Rome Convention by way of a regulation or directive. In order to obtain the views of European Union member States, industry and practice, the EC has published a "Green Paper on the conversion of the Rome Convention into a Community instrument and its modernization (COM(2002) 654 final) of 14 January 2003", posted on the EC web site (hereinafter referred to as "the Green Paper").¹⁰

21. Question 18 of the Green Paper reads as follows: "Do you believe that a future instrument should specify the law applicable to the conditions under which the assignment may be invoked against third parties? If so, what conflict rule do you recommend?"¹¹

22. In the comments contained in the Green Paper under “possible solutions” (3.2.13.3, point iv), it is mentioned: “application of the law of the assignor’s residence: this is the solution best capable of satisfying the criterion of foreseeability for third parties. Thus was this solution adopted by the United Nations Convention on the assignment of claims in international trade [footnote 89].”¹²

23. Article 22 of the United Nations Assignment Convention adopted the law of the assignor’s location because it is the only approach that (with the appropriate location rule) is most likely to produce a single law, a law that is, in most cases, easily determinable by all parties and a law that is the law of the jurisdiction in which the main insolvency proceeding with regard to the assignor will most likely be opened (also under EC Regulation No. 1346/2000 of 29 May 2000 relating to insolvency proceedings). All those considerations were thought to be essential for the availability and the lower cost of credit, an objective that is unlikely to be achieved if there is no certainty as to the applicable law. In this connection, the risk of the insolvency of the assignor was one of the most important considerations taken into account by the Commission. In the typical receivables financing transaction which involves several receivables owed by several debtors, the main risk for the assignee is not that one of many debtors may not pay but rather that a creditor of the assignor and, in particular, the administrator in the insolvency of the assignor, may claim and obtain the entire pool of the receivables assigned.

24. Under the United Nations Assignment Convention, the assignor is located at its place of business. The assignor is a single person and its place of business should be easily ascertainable by all parties. Where the assignor has no place of business, reference is to be made to its habitual residence. Where the assignor has a place of business in more than one State, the assignor is deemed to be located at the place where its central administration is exercised (art. 5 (h) of the United Nations Assignment Convention). The place of central administration is a place easily determined in the vast majority of cases. An approach based on the place of business of the assignor with the closest connection to the relevant transaction (see art. 4 (2) of the Rome Convention) was considered by the Commission and rejected because it did not provide sufficient certainty (in the case of assignments of future receivables) or could produce more than one law applicable (in the case of bulk assignments) and thus could have a negative impact on the availability and cost of credit. An approach based on the place of registration was also rejected as, in some cases, there could be more than one place of registration.

25. Moreover, the Commission was conscious that the approach it adopted might not produce one single law if the assignor made an assignment, moved its central administration to another country and then made a second assignment of the same receivables to another assignee. A provision that would have addressed this problem was considered but it was decided that there was no need for a such provision since a move of central administration takes significant time and the concerned assignees could then take the necessary precautions; it was also noted that assignors would be unlikely to make such moves just for defrauding assignees by making a second assignment of the same receivables.

3. Conclusions

26. The Commission may wish to recommend that every effort be made to avoid that a revised article 12 of the Rome Convention in a future Community instrument takes a different approach than article 22 of the United Nations Assignment Convention.

27. The rule of article 22 of the United Nations Assignment Convention is the rule most likely to increase the availability and reduce the costs of credit within the EU itself. If the EU adopts a rule different than article 22 of the United Nations Assignment Convention, which other countries have adopted or are about to adopt, whether through their own domestic legislation or by adopting the United Nations Assignment Convention, then the EU would be decreasing the availability of credit and increasing its costs not only within the EU but also for cross-border transactions involving EU trading partner countries whose laws have adopted or are otherwise consistent with article 22 of the United Nations Assignment Convention.

28. For example, if the European Union and its major trading partners have different rules with respect to the law governing third-party effects of assignments, in a priority conflict between a United States assignee and a German seller with a retention of title extending to the proceeds from the further sale of the goods, different laws would apply to the same priority conflict depending on whether the dispute is brought before a United States or a German court. This uncertainty could defeat certain receivables financing transactions or at least raise their cost.

29. Also, if the European Union adopted a different rule just for parties located in EU member States, one law would apply to priority conflicts between EU parties and another between EU and non-EU parties, a result that could raise enormous practical difficulties and costs.

30. The same result may be obtained even if the revised article 12 were to adopt, as article 22 of the United Nations Assignment Convention does, an approach based on the assignor's law. This could happen since, under article 4.2 of the Rome Convention, the closest connection test may produce a law other than the law of the assignor's habitual residence or central administration. For example, unless reference were made directly to the law of the assignor's habitual residence or central administration (see para. 24), a conflict of priority between a French and a United States bank receiving an assignment by a French branch of a United States assignor, under revised article 12 of the Rome Convention, could be subject to French law (the law with the closest connection to the assignment), while under article 22, it would be subject to United States law (the law of the central administration of the United States corporation).

31. In this light, in its comments on the Green Paper, the German Government noted that it is worth examining whether any new European legislation on the law applicable to third-party effects of assignments should be aligned with the United Nations Assignment Convention.¹³ Taking this matter further, in its comments the Max-Planck Institute for Foreign and Private International Law and the Hamburg Group for Private International Law recommended the adoption of an approach based on the assignor's habitual residence or, in the case of legal persons, the assignor's central administration.¹⁴

32. In its comments on the Green Paper, the International Chamber of Commerce responded that the “ICC would prefer to see this issue dealt with within the Bankruptcy Directive or the UNCITRAL Assignment Convention. ICC believes that the European Commission’s best choice would be a mandate to collectively ratify the UNCITRAL Assignment Convention for all EU countries and drop the current article 12 from the Rome Convention, if revised”.¹⁵ Such a solution presents the advantage that it does not require a revision of articles 12 and 4.2 of the Rome Convention, resolves the substance of the matter in the most appropriate way and avoids delaying EU and other States from obtaining the benefits to be derived from ratification of the United Nations Assignment Convention.¹⁶

Notes

- ¹ *Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17)*, para. 100.
- ² *Ibid.*, *Fifty-sixth Session, Supplement No. 17 (A/56/17)*, para. 351.
- ³ See at <http://www.unidroit.org>.
- ⁴ See Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific To Aircraft Equipment, Official Commentary by Professor Sir Roy Goode CBE, QC, Rome, September 2002, para. 22.
- ⁵ See <http://www.ebrd.com/country/sector/law/st/prin/main.htm>.
- ⁶ See <http://www.ebrd.com/country/sector/law/st/modellaw/modlaw0.htm>.
- ⁷ See http://www.adb.org/Documents/Others/Law_ADB/lpr_2000_2.asp?p=lawdevt.
- ⁸ See http://www.adb.org/documents/reports/movables_registries/default.asp.
- ⁹ See <http://www.oas.org/main/main.asp?sLang=E&sLink=http://www.oas.org/documents/eng/documents.asp>.
- ¹⁰ See http://europa.eu.int/comm/justice_home/news/consulting_public/rome_i/news_summary_rome1_en.htm.
- ¹¹ *Ibid.*
- ¹² *Ibid.*
- ¹³ See http://europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/bundesrepublik_deutschland_de.pdf.
- ¹⁴ See *Rabels Zeitschrift*, 67 (2003) 1, 45 and 51 and http://europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/max_planck_institute_foreign_private_international_law_en.pdf.
- ¹⁵ See http://europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/international_chamber_commerce_en.pdf.
- ¹⁶ So far, Luxembourg, Madagascar and the United States of America have signed the Convention. See <http://www.uncitral.org> [Status of texts].