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Assignment in receivables financing

Discussion and preliminary draft of uniform rules

Report of the Secretary-General

Contents

INTRODUCTION

1. At its thirteenth session (New York, 14-25 July 1980), the Commission considered a report by the Secretariat on security interests in different kinds of assets, including receivables. [1] At that session, the conclusion was reached that "worldwide unification of the law of security interests ... was in all likelihood unattainable" since the subject was too complex. It was noted that it was advisable for the Commission to await the outcome of the work on the retention of title by the Council of Europe and on factoring by the International Institute for the Unification of Private Law (UNIDROIT), prior to the Commission undertaking any further work of its own. [2] Subsequently, at the Congress on International Trade Law held by the Commission in conjunction with its twenty-fifth session in May 1992 in New York, it was suggested that work should be undertaken by the Commission on assignment of claims, an issue beyond the scope of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; "the Sales Convention").

2. Pursuant to that suggestion, at its twenty-sixth session (Vienna, 5 to 23 July 1993), the Commission considered a note by the Secretariat concerning certain legal problems in the area of assignment of claims and of past and current work on assignment and related topics.[3] The

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[1] A/CN.9/186, reproduced in UNCITRAL Yearbook, vol XI:1980, part two, III, D; for a full list of the relevant reports of the Commission's work on this topic, see A/CN.9/378/Add.3, footnote 2.

[2] Report of the United Nations Commission on International Trade Law on the work of its thirteenth session (1980), Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17), paras. 26-28, (UNCITRAL Yearbook, vol. XI:1980, part one, II, A).

[3] A/CN.9/378/Add.3.

Commission then requested the Secretariat to prepare a study on the feasibility of unification work in the field of assignment of claims.[4] In response to that request, the Secretariat presented to the Commission, at its twenty-seventh session (New York, 31 May to 17 June 1994), a report on legal aspects of receivables financing.[5] The report focussed on assignment of claims for financing purposes (i.e., for raising income or credit) and suggested that a number of assignment-related problems could be addressed by uniform rules. At that session, the Commission requested the Secretariat to prepare a further study that would discuss in more detail the issues that had been identified and would be accompanied by a first draft of uniform rules.[6]

3. The present report has been prepared pursuant to that request. The first part discusses the possible scope of work; the second part addresses a number of assignment-related issues and suggests some possible solutions to problems arising in the context of receivables financing. Interspersed in the report are first, preliminary drafts of uniform rules on certain of the issues ("the draft uniform rules").

4. The purpose of such rules would be to respond to the practical commercial need to utilize receivables to obtain financing. At present, in view of divergences among legal systems, cross-border assignments (in which the assignor, the assignee and the debtor would not be in the same country) may be unenforceable against the debtor or be challenged by creditors of the assignor in another country. This is particularly the case with respect to recognition of the validity of bulk assignments of future receivables, which is the usual form in which receivables financing takes place. Such difficulties are particularly likely to be evidenced, for example, in case of the insolvency of the assignor, and when conflicting claims arise as to the receivables. The practical result is that the use of commercial receivables to obtain needed financing is hindered or may be more costly.

5. As envisaged in the present report, the uniform rules would build on the rules contained in existing international instruments, such as the Sales Convention and the UNIDROIT Convention on International Factoring (Ottawa, 1988; "the Factoring Convention", which enters into force on 1 May 1995 for France, Italy and Nigeria). With a view to furthering harmony of law, they would presumably also take into account solutions reflected in the Rome Convention on the Law Applicable to Contractual Obligations (Rome, 1980; "the Rome Convention").

6. In the context of its cooperation with interested international and national organizations, the Secretariat made a preliminary draft of this report available to UNIDROIT, the Hague Conference on Private International Law, the European Bank for Reconstruction and Development (EBRD), the International Bank for Reconstruction and Development (IBRD) and, in the United States, the National Conference of Commissioners on Uniform State Laws for their comments.

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[4] Report of the United Nations Commission on International Trade Law on the work of its twenty-sixth session (1993), Official Records of the General Assembly, Forty-eighth Session, Supplement No. 17 (A/48/17), para. 301.

[5] A/CN.9/397.

[6] Report of the United Nations Commission on International Trade Law on the work of its twenty-seventh session (1994), Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17 (A/49/17), para. 210.

I. SCOPE OF WORK

A. General remarks

7. It is assumed in the present report that work by the Commission would focus on assignments in receivables financing, i.e., assignments effected for raising income or credit on the basis of receivables. As described in section I.C., such receivables financing takes various commercial forms, including factoring, forfaiting, refinancing, securitization and project financing. The "assignment" in each of those forms involves a transfer by the original creditor (assignor) to a new creditor (assignee) of receivables arising from a contract ("the original contract"; e.g., a sales contract) between the assignor and a third party (debtor); the transfer may be by way of sale, by way of security, or otherwise.

8. In receivables financing, the assignment is effected in connection with a contract between the assignor and the assignee to transfer receivables, in connection with which the assignee provides financing to the assignor. An important characteristic of such assignment is that it establishes a "triangular relationship" between the assignor, the assignee and the debtor, in the sense that while the payment claim is transferred, the obligation to perform the original contract remains with the assignor. The assignment can produce effects against other third parties, such as the assignor's creditors and the trustee in the bankruptcy of the assignor.

9. In terms of contractual structure, the assignment element of a receivables financing transaction may be embodied, depending upon the type of case, as an integral term in the financing contract (e.g., in a factoring transaction), or it may be a distinct contract in a web of contracts (e.g., assignment of future revenues in project financing).

10. While it is assumed that work by the Commission would be limited to assignment in receivables financing, it may not be sufficient simply to define the scope in terms of receivables arising from transactions that are not for personal, family or household purposes (art. 2(a), Sales Convention; art. 1.2(a), Factoring Convention). A more appropriate approach in the present context may be to look to the commercial purpose of the assignment itself, since most assignments in receivables financing transactions are for commercial purposes, even if the receivables themselves may derive from consumer transactions. Such an approach would cover, for example, refinancing or securitization of credit card consumer receivables, home equipment loans and home mortgages. Issues of consumer protection might be dealt with in conjunction with the question of protection of the debtor.

11. While it can be assumed that applicability of the uniform rules would hinge on internationality, several specific questions present themselves as to the extent of the internationality to be required. These include not only whether the assignor and debtor would need to have their places of business in different States, or whether one should look to the places of business of the assignor and the assignee, but also whether a bulk assignment would be covered only if all debtors, or merely if one debtor is located in a different country, and what the effect would be of the debtor moving to a different country after the assignment is effected.

12. Considerations that may weigh on such choices include, for example: whether the law governing the receivable should change simply because of a cross-border assignment; the potential for inconsistent results in assignments of domestic receivables as between a domestic assignee and a foreign assignee both of whom may in fact be part of a single loan syndicate; and desirability of

consistency with the Factoring Convention, which covers both domestic and international assignments of international receivables.

13. As to the territorial scope of application, requiring that the assignee be located in a State that has enacted the rules could be questioned, since the demand for payment would normally be made at the place of business of the assignor or the debtor.

B. Various types of assignment and similar practices

14. Assignment may be effected by way of sale, by way of security, or in payment of a preexisting debt. Apart from legal systems that deal with assignment of trade receivables in terms of those three main categories, there are used in some legal systems functional equivalents of assignment of receivables, including techniques such as subrogation, pledge or novation (see paras. 22 to 29). Consideration might be given to preparing a set of uniform rules that would cover all those ways in which receivables might be transferred, without necessarily, having to formulate precise definitions of the various forms.

15. Some legal systems impose specific conditions for effectiveness of assignment by way of security, which may not be applicable to assignment by way of sale, including, for example: written form and notification of the debtor, or registration, for effectiveness of the assignment as between the assignor and the assignee, or as against the debtor and other third parties; collection of the receivables by the assignee only in case of assignor's default under the receivables financing contract; return to the assignor of any surplus remaining after payment to the assignee.

16. Other ways in which the treatment of the two types of assignment may differ include the imposition of taxation on income generated from assignments by way of sale, but not on the credit obtained in the context of an assignment by way of security, though the latter may be subject to stamp duty. Furthermore it may be that receivables sold may be taken off the balance sheet of the assignor, which might improve the return-on-assets or capital-to-assets calculations of the assignor, and consequently the creditworthiness of the assignor.

17. Assignment in payment of a pre-existing debt is either an assignment by way of sale or an assignment by way of security, or a way of payment (if, e.g., it is effected in repayment of an advance made in the context of a loan or an overdraft facility, where the consideration might be an advance and not a purchase price, and the assignment might be effected in order to repay the advance rather than to secure repayment of the advance).

18. In some legal systems, pledge is the main legal technique by which receivables may be transferred by way of security, and the assignment must meet the requirements of pledge in order to obtain recognition (e.g., writing, delivery and registration). The pledgee of receivables normally acquires only the right to be paid out of the proceeds of the receivables in preference to other creditors of the pledgor in case the pledgor fails to pay under a receivables financing contract concluded with the pledgee.

19. Another functionally equivalent technique that is used is subrogation, which, like assignment, involves a triangular relationship between the creditor (subrogor), a third party paying and taking the place of the creditor (subrogee) and the debtor. Typically, it is required that the subrogation be express and that it take place at the same time as funds are provided in exchange for the

receivables. In some countries, factoring is practiced by way of subrogation, in order to avoid the formal requirements imposed on assignments (notarial document and notification of or consent by the debtor).

20. A further technique analogous to assignment that is used is novation, involving the change of the creditor. This requires, like assignment, an agreement between the original and the new creditor and is used in some countries where the assignment requires notarial notification or consent of the debtor. An important difference from assignment is that novation does not result in the transfer of the old receivable but in the creation of a new one (as a result rights securing the old receivables are extinguished).

21. Notwithstanding the above types of differences among various ways of transferring receivables, in practice parties often negotiate among themselves a number of economic variations that may diminish the practical effect of such conceptual distinctions. For example, while by definition in sales of receivables the assignee is entitled to retain any surplus beyond the amount paid for the receivables, sales of receivables are frequently structured with "hold back" provisions providing for return to the assignor of any surplus collections. This may be an indication that it may be feasible to formulate a legal text that would foster cross-border recognition of assignment of receivables for financing purposes, and various functional equivalents of such assignment, despite certain conceptual and technical differences that exist among various legal systems.

C. Commercial forms of receivables financing

1. Factoring

22. In factoring, trade receivables are sold by the assignor ("supplier") to the assignee ("factor"), in return for advances or credit and the provision of services by the factor such as bookkeeping, collection of receivables and protection against default by the debtors. In "recourse factoring" the assignee has a right to turn to the assignor if the debtor is insolvent or unwilling to pay.

23. To avoid conflict or overlap with the Factoring Convention, work by the Commission could be aimed at factoring contracts not covered by the Factoring Convention: i.e., factoring contracts in the context of which only financing, or just one of the other services mentioned above is offered; non-notification factoring; factoring of receivables arising not only from sales and services contracts but also from leases and contracts on the basis of which equipment or facilities are made available (and possibly of other types of receivables). In addition, regarding factoring contracts subject to the Factoring Convention, such work might address issues not addressed in the Factoring Convention (e.g., conflicts of priority among several creditors laying a claim on the assigned receivables). In such a way, together with the Factoring Convention, a more comprehensive international legal regime on assignment in receivables financing could be established.

24. Apart from the Convention, which is not yet widely in force, factoring practice has attempted to address the problem of recognition and enforcement of cross-border assignments through the so called "two-factor" approach. This involves two consecutive assignments, one from the exporter to a factor in its own country, and another from the first factor to a second factor in the debtor's country. However, the problem of recognition and enforcement of cross-border bulk assignments of future receivables still may remain if the law of the debtor's country does not recognize the validity

of such assignments. In addition, the operation of a "two-factor" system might be difficult, time consuming and costly where multiple debtors are spread over several countries.

2. Forfaiting

25. Similarly to factoring, forfaiting involves the discounting (purchase) of documentary or non-documentary receivables without recourse to the party from whom the receivables are purchased. It might not be advisable to cover the forfaiting of receivables in the form of negotiable instruments, such as bills of exchange or promissory notes, which are given in payment of a debt. Their transfer raises different problems and is, to some extent, regulated by other international legal instruments (for more details, see A/CN.9/397, para. 13).

3. Refinancing and securitization

26. "Secondary financing", or "refinancing", involves a transaction between the first and a subsequent assignee (e.g., assignment from bank to bank), with the possibility also of yet further re-assignments. Refinancing of receivables is faced with the same problem of the possible invalidity or ineffectiveness of cross-border assignments. The question may arise, however, whether to exclude more complicated refinancing transactions, in which, for example, parts of a pool of receivables are assigned to different parties, or in which the capital of a loan is assigned to one financing institution and the interest of the same loan is assigned to another financing institution.

27. In securitization, marketable assets (e.g., trade receivables) or non-marketable assets (e.g., consumer credit card receivables, healthcare receivables, home equipment loans, home mortgages) are packaged by the lender in pools of receivables and transferred to a company controlled by the lender, whose single purpose is to issue securities, sell them and use the proceeds to purchase the receivables. This removes the receivables from the lender's balance sheet and replaces them with cash, with possible resulting tax and accounting benefits. It also allows the lender to make a profit stemming from the difference between the interest paid to the securities-holders and that paid by the debtors of the assigned receivables.

28. Internationally, securitization is widely practiced as sales of participations in syndicated loans, though problems may arise as a result of the disparity of laws in the differing ways in which assignments by way of sale are treated. Another potential difficulty in cross-border securitization is the invalidation of bulk assignments of all present and future receivables, as such assignments form the basis of securitization.

4. Project finance

29. In project finance, finance is provided to a project contractor by way of a loan, and repayment of the loan is effected or secured through the future revenues of the project. Among the components of a typical project-finance contractual structure are sales agreements between the project contractor or operator and the prospective purchasers of the resultant products of the project, and an assignment of revenues from such sales to the lenders that finance the construction. The typical characteristics of the assignment are that it is a bulk assignment of future receivables,

typically by way of security, based on the presumed ability to repay the loan through revenues generated by the project.

30. "Draft article 1. Scope of application

(1) These rules apply to the assignment for [commercial] [financing] purposes of receivables between an assignor and one or more debtors whose places of business are in different States:

(a) when the States [are Contracting States] [have adopted the rules]; or

(b) when the rules of private international law lead to the application of the law of [a Contracting State] [this State].

(2) For the purposes of this [Convention] [law]:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the [contract giving rise to the receivables] [assignment] and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the time of the [conclusion of the contract] [assignment];

(b) if a party does not have a place of business, reference is to be made to its habitual residence.

"Draft article 2. Definitions

(1) "Receivable" means any right of a creditor to receive or to claim the payment of a monetary sum, unless it is in the form of a bill of exchange or a promissory note.

(2) "Assignment of receivables" means the transfer, by way of sale, as security for performance of an obligation, or otherwise, from one party ("assignor") to another party who provides financing to the assignor ("assignee") of receivables arising from a contract ("the original contract") made between the assignor and a third party ("the debtor")."

(3) "Financing contract" means the contract by which the assignee provides financing to the assignor."

II. POSSIBLE ISSUES

A. Bulk assignment

31. An important aim of the uniform rules would be to overcome uncertainty in various legal systems with regard to the validity of the assignment of more than one receivable, e.g., assignments in which receivables are not specified individually, sometimes referred to as "bulk assignment".

32. This goal might be achieved in a balanced way, without inadvertently fostering undue restrictions on the future economic activity of the assignor, if pools of receivables could be assigned, provided that, at the time of assignment or when they come into existence, they would be

related to particular contracts from which they might arise (identification of receivables; draft article 3(1) and 2). However, a requirement that receivables should be specified individually as to the identity of the debtor and their exact amount would render the bulk assignments of future receivables impracticable.

33. Related questions include whether receivables "come into existence" when they fall due or when the contract from which they might arise is concluded; whether, if some of the receivables in a pool cannot be identified to the contract from which they might arise, the assignment of the whole pool of receivables would be invalid; and how to establish the validity of such assignments as against the debtor and third parties without prejudicing their rights. As regards the debtor, this might be achieved by making the debtor's duty to pay the assignee contingent upon receipt of written notification of the assignment, and as regards the interests of third parties, by an adequate publicity system.

B. Future receivables

34. Some uncertainty exists in various legal systems as to the validity of assignments of future receivables (including receivables yet to arise from contracts existing at the time of assignment and receivables which may arise under contracts non-existing at that time). Questions related to the recognition of assignments of future receivables include, for example, whether: a new act of transfer should be required when the receivables come into existence; the assignment of conditional receivables should also be expressly covered as future receivables; and receivables could be deemed to be acquired automatically by the assignee when they arise, which approach, if followed, might have implications as to whether the receivables could be considered ever to enter the estate of an insolvent assignor.

35. "Draft article 3. Assignment of receivables

(1) An assignment of one or more receivables is effective if, when the assignment is effected or when the receivables come into existence, they can be identified as receivables to which the assignment relates.

(2) The assignment of future [or conditional] receivables operates to transfer the receivables directly to the assignee when they come into existence [or when the condition is fulfilled] without the need for a new assignment."

C. No-assignment clauses

36. Contracts routinely contain clauses prohibiting or restricting assignment. Such clauses may be intended in particular to protect the debtor from uncertainty as to whom to pay. However, the same end could be served by a rule requiring the debtor to pay the assignee only upon proper notification (draft article 9).

37. A related question is whether the debtor should be allowed to setoff against the assignee a claim for damages due to the debtor by the assignor for breach of a no-assignment clause (draft article 10(2)). Such a rule could conceivably have the effect of recreating the problem caused in the first place by no-assignment clauses. In addition, the assignor might be held liable to the assignee for breach of warranty to the extent that the value of the assigned receivables was negated

(see para. 46). Another question is whether there would be a need to distinguish the case of current accounts in which individual claims have not been deemed by applicable law to be independent, and thus only the current account balance has been subject to assignment.

38. "Draft article 4. No-assignment clauses

(1) Subject to article 9, the assignment of receivables shall be effective notwithstanding any agreement between the assignor and the debtor prohibiting or restricting such assignment.

(2) Subject to article 10(2), nothing in paragraph (1) of this article shall affect any obligation or liability of the assignor to the debtor in respect of an assignment made in breach of the original contract."

D. Transfer of security rights

39. The question may arise whether to include in the uniform rules a provision on whether an assignment automatically transfers the assignor's rights securing payment of a receivable depending on the nature of the security rights involved. In some legal systems, "accessory rights", i.e. those rights that cannot exist or be transferred independently from the receivable, the payment of which they are intended to secure, are considered to be transferred automatically; non-accessory security rights, i.e., rights that may exist or be transferred independently, require a separate act of transfer. It may be noted that the Factoring Convention addresses the issue by recognizing contractual autonomy on the matter of transfer of related rights.

40. It may be noted that the question of whether the transfer of related rights should be addressed in the draft uniform rules, or perhaps left to the applicable local law, may be raised in particular with respect to related rights of a proprietary nature (e.g., a non-accessory mortgage that has to be registered). Among other questions that may be raised is the relationship between a provision recognizing contractual autonomy and transfers of related rights by operation of law.

E. Form of assignment

41. In considering whether the uniform rules should impose any requirements of form for the purpose of validity of an assignment, it may be noted that, in practice, assignments are effected by written or oral agreement, which may be accompanied by an additional act, such as notification or consent of the debtor, or registration.

42. While written form is beneficial from the standpoint of certainty and evidence, and as a warning to the parties, in particular in case of bulk assignments of future receivables, introducing a mandatory form requirement could make assignment unnecessarily more difficult and costly. In addition, the protection of the debtor provided by a notification requirement might be achieved more simply by giving the debtor a right to refuse to pay the assignee without such notification.

43. Similarly, requiring consent of the debtor for the validity of assignment could be seen as burdening the use of receivables for credit, without adding significantly to the necessary protection of the debtor. Moreover, registration, though potentially useful in providing notice to third parties about the assignment, could, if required for the validity of assignment, hinder the significant

commercial practice of "non-notification" assignment, i.e., assignment which is not notified to the debtor or any other third party.

44. "Draft article 5. Form

An assignment need not be effected or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses."

F. Relationship between assignor and assignee

45. Consideration might be given to addressing certain contractual issues that might affect the transfer of receivables (such as breach of the receivables financing contract or breach of warranties undertaken by the assignor in the contract of assignment).

46. It is widely accepted that an assignor warrants that assigned receivables exist, that the assignor is the rightful creditor and its right in the receivables does not have any "hidden legal defects", e.g., a defence of the debtor or a third party's claim that could deprive the receivables of value (draft article 6).

47. A question that may be considered is whether it would be appropriate to include in the draft uniform rules a rule on the consequences of breach of the warranty, including whether such a breach would result in any rescission effects, whether any such effects should hinge on a notion of "fundamental breach", and whether, in the event that rescission took place, any receivables that did exist under the rescinded assignments would be considered to be transferred back without an additional act of "re-transfer". The latter question may be of particular importance in case of intervening insolvency of the assignee, since the assignee might not be considered to have the capacity to retransfer the receivables.

48. Another question, which would also have implications in case of the assignee's insolvency, concerns the point of time, in the context of assignments of future receivables, at which the receivables may be deemed to come into the possession of the assignee, and at what time any attendant warranties would attach.

49. In case of breach of the receivables financing contract by the assignor (e.g., the assignor does not repay the loan received from the assignee), the assignee would normally have an interest in collecting from the debtors of the assigned receivables (draft article 7(2)). The exact nature of the options available to the assignee may depend on the nature of the assignment. In the case of an assignment by way of security, the assignee would typically have to return to the assignor any surplus, or claim compensation for any shortfall. In the case of a sale of the receivables, the assignee is normally able to collect the assigned receivables when they fall due and to retain any surplus, while bearing the risk of collecting less than it paid (draft article 7(3) and 7(4)).

50. Other matters arising between the assignor and the assignee as a result of the contract of assignment or the transfer of receivables could be left to be dealt with by other applicable law, for the determination of which a rule might be provided. One possibility would be that, in the absence of a choice by the parties, the contract of assignment could be governed by the law of the place of business of the assignor. A rule based on the assignor's place of business would have the advantage of simplicity and predictability.

51. An alternative would be a rule based on the notion of "closest relationship", along the lines adopted in the Rome Convention. Inherently more flexible, such an approach could result in the application of the law of the assignor's place of business (e.g., in an assignment by way of sale), or the law of the assignee's place of business (e.g., in recourse factoring in which the factor might perform book-keeping and collection functions). However, such a rule would have the disadvantage of reduced predictability (draft article 8(1)).

52. A question of importance, in particular in case of insolvency of the assignor or of the assignee, is which one of them is the rightful creditor. It might not be appropriate to subject this question, which is one of the transfer itself rather than of the underlying contract of assignment, to the law chosen by the assignor and the assignee since their choice could significantly affect the debtor and third parties. More appropriate, in particular for reasons of simplicity and predictability, may be the law of the country where the assignor has its place of business. By contrast, a rule providing for the application of the law governing the receivable could lead to the application of the law of the original contract, which may be the law chosen by the assignor and the debtor. Furthermore, in case the original contract does not yet exist at the time of assignment, which is often the case, the assignee would not be able to know which law will govern the question of when the assignee acquires the receivables (draft article 8(2); see also article 12.2 of the Rome Convention).

53. "Draft article 6. Warranties

(1) Unless otherwise agreed between the assignor and the assignee [in the contract of assignment], the assignor warrants to the assignee that the assigned receivables exist.

(2) For the purposes of paragraph (1) of this article, the receivables shall be considered as existing if the assignor is the creditor, has a right to transfer the receivables and has no knowledge, at the time of assignment, of any fact that would deprive the receivables of value.

(3) Unless otherwise explicitly agreed between the assignor and the assignee [in the contract of assignment], the assignor does not warrant towards the assignee that the debtor will pay.

"Draft article 7. Assignor's breach of financing contract

(1) When so agreed, and in any event if the assignor defaults on its obligation to pay in accordance with the financing contract, the assignee is entitled to notify the debtor pursuant to article 9 to pay the assignee.

(2) In an assignment by way of sale, unless otherwise agreed by the assignor and the assignee, the assignee may retain any surplus, and the assignor is not liable for any deficiency.

(3) In an assignment by way of security, unless otherwise agreed by the assignor and the assignee, the assignee must account to the assignor and return any surplus, and the assignor is liable for any deficiency."

"Draft article 8. Law applicable to the relationship between assignor and assignee

(1) [With the exception of matters which are expressly settled in these rules,] the rights and obligations of the assignor and the assignee[, including the question of the point of time at which the assignee becomes the rightful creditor of the receivables,] are governed by the law the choice of which is:

(a) Stipulated in the assignment; or

(b) Agreed elsewhere by the assignor and the assignee.

(2) (a) In the absence of a choice by the parties, the rights and obligations of the assignor and the assignee[, including the question of the point of time at which the assignee becomes the rightful creditor of the receivables], and with the exception of matters which are expressly settled in these rules, are governed by the law of the State in which the assignor has its place of business.

(b) For the purposes of subparagraph (a), in case the assignor has more than one place of business, the place of business is that which has the closest relationship to the assignment, having regard to the circumstances known to or contemplated by the assignor and the assignee at any time before or at the conclusion of the assignment.

G. Effects of assignment towards the debtor

1. Debtor's duty to pay

54. The baseline question as to the debtor's duty to pay the assigned concerns the conditions that must be present for payment to the assignee to result in discharge of the debtor's payment obligation. If notification of the assignment is made the necessary condition, the debtor who pays the assignee before notification would not be entitled to discharge. Any other approach may be viewed as unjustifiably burdening the debtor with the impracticable task of searching for possible assignments prior to making payment.

55. Assuming that an approach based on notification would be adopted, a number of questions present themselves. With a view to certainty in the transaction, it would seem preferable to require that the notification be unconditional, since otherwise the assignee would bear the risk of the notification being ineffective. A requirement that the notification be in writing, which could be broadly formulated (see Annex to A/CN.9/406, draft UNCITRAL Model Law on Legal Aspects of Electronic Data Interchange (EDI) and Related Means of Communication, articles 2(a) and 5), would also seem a necessary measure for the debtor's protection. An additional basic protection would require that the notification be issued by the assignor or, if issued by the assignee, with the assignor's authority. Such an approach would take account of various practices, for example, the assignee may obtain at the time of assignment blank notices signed by the assignor (and send them to the debtor when necessary), or an irrevocable power of attorney may be given by the assignor allowing the assignee to notify on its own.

56. Other questions relating to notification include: whether the debtor has to ignore the notification issued after the effective date of the insolvency of the assignor or of the assignee,

particularly if the insolvency proceedings take place in the debtor's country; whether notification may be effective as to identified future receivables, as would be essential to affirm in line with the recognition of the validity of assignments of future receivables; whether the debtor, if in doubt as to some aspect of the assignment, may require information additional to that contained in the notification; whether a requirement of a written notification could be met, in cases in which the assignment was in writing, by providing the debtor with the assignment itself; and whom the debtor is to pay in case it receives more than one notification (e.g., from several assignees, or from the assignee and judgement creditors of the assignor, or from the assignee and the trustee in the insolvency of the assignor).

57. One way to address the question of multiple notifications is to require that the debtor may pay the first person to notify, taking into account, however, that it would not be intended to preclude subsequent notifications of "reassignment" by earlier assignees in the chain. Objections could be expected to making a "first to notify" approach subject to the debtor's not knowing of any other person's "superior right to payment", an approach found in article 8.1 of the Factoring Convention, as there might be seen as placing an undue burden of investigation on the debtor and potentially undermining the practical utility of assignment of receivables in view of the reduced degree of clarity and simplicity.

58. A further point relating to a "first to notify" rule that may warrant attention is that in some legal systems an insolvency trustee need not notify the debtor, as the debtor is deemed to have constructive knowledge of the assignment to the insolvent entity as of the effective date of the insolvency. A related question is whether the effects of such a constructive knowledge rule should be limited to insolvency trustees in the country of the debtor where a "constructive knowledge" rule might exist.

59. An additional question that may be considered concerns the relationship between the uniform rules and the possibility of discharge of a debtor that pays the assignee pursuant to a notification meeting the requirements of domestic law but not necessarily those of the draft uniform rules. It may be argued that allowing such discharge would be consistent with the need to protect the debtor without necessarily running counter to the interests of the assignee or the assignor, in particular since the assignor would have transferred its receivables and received the corresponding benefit, and the assignee would have been paid.

60. "Draft article 9. Debtor's duty to pay

(1) The debtor is entitled, until the debtor receives notification in writing of the assignment in accordance with paragraph (2) of this article, to pay the assignor and be discharged from liability.

(2) The debtor is under a duty to pay the assignee if the debtor has not received notification in writing of a prior assignment, of a judgement attaching the assigned receivables [or of the insolvency of the assignor] and:

(a) the debtor receives [an unconditional] notification in writing of the assignment by the assignor or by the assignee with the assignor's authority; and

(b) the notification reasonably identifies the receivables assigned and the assignee to whom or for whose account the debtor is required to make payment.

(3) If requested by the debtor, the assignee must furnish within a reasonable period of time adequate proof that the assignment has been made, and unless the assignee does so, the debtor may pay the assignor and be discharged from liability.

(4) "Notification in writing" means a notification provided in a form that the information contained therein is accessible so as to be usable for subsequent reference, including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy.

(5) Irrespective of whether the assignment is in writing or not, a summary statement in writing about the assignment in accordance with paragraph (2) of this article constitutes notification in writing under paragraph (4) of this article.

(6) Payment by the debtor to the assignee shall discharge the debtor from liability if made in accordance with this article or other applicable law.

2. Defences of the debtor and setoff

61. A basic question to be considered is the extent to which the draft uniform rules should permit the debtor to raise defences and to exercise a right of setoff in paying the assignee. The debtor is widely recognized as entitled to raise against the assignee the defences that the debtor could have raised against the assignor arising from the contract from which the assigned receivables derive, irrespective of whether they arose before or after assignment or notice thereof.

62. Many legal systems allow also setoff against the assignee of claims arising from a separate contract between the debtor and the assignee, provided that such claims are available to the debtor at the time proper notification of the assignment is given. Rights "available" to the debtor may be those due for payment or simply those in existence. [7]

63. "Draft article 10. Defences of the debtor

(1) In a claim by the assignee against the debtor for payment of the assigned receivables, the debtor may set up against the assignee all defences arising under the original contract of which the debtor could have availed itself if such claim had been made by the assignor.

(2) Notwithstanding paragraph (1), defences that the debtor could have exercised against the assignor for breach of a no-assignment clause are not available to the debtor against the assignee.

(3) The debtor may assert against the assignee any right of setoff in respect of claims existing against the assignor in whose favour the receivable arose and available to the debtor at the time notification of assignment conforming to article 9 was given to the debtor."

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[7] The Factoring Convention, in articles 9 and 10, lays down only some fundamental principles concerning the debtor's defences leaving matters such as the exact meaning of rights "available" to the debtor for setoff and waiver of defences to the domestic law; see UNIDROIT 1987, Study LVIII-Doc.33, paragraph 44.

3. Waiver of defences

64. Defences of the debtor increase the uncertainty as to whether the assignee will be able to collect from the debtor and thus pose a potential obstacle to receivables financing. To address this uncertainty in practice, a waiver of certain of the debtor's defences is sometimes included in the original contract with the assignor, or is negotiated with the assignee at the time of notification or enforcement. Such waivers of certain defences are widely recognized, with some legal systems assuming a waiver of the debtor's defences if the debtor does not object or consents to an assignment when notified.

65. With a view to avoiding abuse of such waivers, consideration might be given to limiting recognition to waivers of those defences about the availability of which the debtor knew or ought to have known at the time of the waiver. A countervailing consideration would be that that there may not be adequate justification for limiting contractual freedom in this way, and that the draft uniform rules might simply cede to limitations on such waivers found in mandatory rules of other applicable law.

66. "Draft article 11. Waiver of defences

> A waiver by the debtor of the defences that the debtor could raise against the assignee under article 10 shall be valid [in respect of defences the availability of which the debtor knew or ought to have known at the time of waiver]."

4. Recovery of advances

67. It occurs in practice that the debtor pays the assignee before the assignor performs its obligations to the debtor under the original contract. This practice may raise uncertainty in some legal systems, in particular when there has been a default in performance or insolvency prior to performance on the part of the assignor, as to whether the debtor may setoff or recover its advance payment from the assignee. The draft uniform rules might remove some uncertainty by providing that the debtor should not be able to recover such advances from the assignee. Under such a rule, the debtor would be left to bear the risk of insolvency of its contractual partner (the assignor) and would not be given an additional right to turn against the assignee.

68. If such a rule were included, the question would arise whether an exception should be made for the case in which the assignee has not paid or loaned money to the assignor as required under the financing contract. However, such an exception may cast doubt on the independence of the assignment, as well as in effect creating a right of priority of the debtor in case of bankruptcy of the assignee. An exception for the case in which the assignee is aware of the assignor's non-performance also raises potential difficulties, such as the assignee having to determine whether the assignor performed properly its obligations to the debtor, or the debtor having to establish knowledge on the part of the assignee.

69. "Draft article 12. Recovery of advances

> Without prejudice to the debtor's rights under article 10, non-performance or defective or late performance of the original contract by the assignor shall not by itself entitle the debtor to recover a sum paid by the debtor to the assignee, provided that the debtor has a right to recover that sum from the assignor.

5. Law applicable to the relationship between the assignee and the debtor

70. As to issues between the assignee and the debtor not addressed by the draft uniform rules, a private international law rule might be included. In this respect, there are two basic possibilities: the law governing the receivable to which the assignment relates (the law of the original contract) or the law of the country where the debtor has its place of business. The first alternative might not provide an adequate degree of certainty, since in some cases the original contract might not yet exist at the time of assignment, or the rule or the choice that the law governing the contract should be the law might not be recognized where enforcement would be sought. Such a lack of recognition may stem from issues arising between the assignee and the debtor being characterized in various jurisdictions as procedural and thus falling under the law of the country in which enforcement is sought. However, a basic consideration in favour of the first alternative is that the receivable transferred should not change its legal character by virtue of the assignment.

71. As to the second approach, it may be argued that, in view of the drawbacks of the first approach, as well as of the fact that usually the assignee would seek enforcement in the debtor's country, [8] an approach providing more certainty might be to refer to the law of the place of business of the debtor. However, the application of such a rule would not be without some difficulties: the debtor's identity might not be known at the time of assignment; a bulk assignment would have to comply with the law of several countries where various debtors might be located; and the situation of enforcement in a country where the debtor has assets would not be covered. At any rate, the rule could reflect the generally accepted principle that the assignment should not alter the position of the debtor, except to the extent permitted by the law under which the debtor undertook an obligation towards the assignor in the first place (see article 12.2 of the Rome Convention).

72. "Draft article 13. Law applicable to the relationship between the assignee and the debtor

> With the exception of matters which are expressly settled in these rules, any matter arising between the assignee and the debtor shall be governed by the law [governing the receivable to which the assignment relates.] [of the State where the debtor has its place of business. In case the debtor has more than one place of business, the place of business is that which has the closest relationship to the transfer of receivables, having regard to the circumstances known to or contemplated by the assignor and the assignee at any time before or at the conclusion of the contract.]"

H. Effects of assignment towards third parties

73. Conflicts of priority among two or more claimants to the receivables may arise, for example, in the following situations: between several assignees, due to multiple assignments of the same receivables because of fraud or an unconscionable act of the assignor; between the assignee and the assignor's judgement creditors attaching the receivables; and between the assignee and the

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[8] Dalhuisen, The assignment of claims in Dutch private international law, in: Comparability and Evaluation, Essays on Comparative Law, Private International Law and International Commercial Arbitration in honour of Dimitra Kokkini-Iatridou, T.M.C. Asser Institute, The Hague, 1994, pp. 183 et sequ.

assignor's insolvency trustee. The key issue in such cases therefore is who among the several claimants will be able to satisfy its claim first in preference to the other creditors.

74. Various possible approaches may be contemplated for a rule on priorities. A rule giving priority to the first assignee (in actual time) would have the advantage of simplicity (draft article 14(1), Variant A). Where such an approach is followed, third parties tend to be protected by the general knowledge that they possess about receivables financing contracts in the relevant market. Various jurisdictions follow a "first to notify the debtor" rule (draft article 14(1), Variant B). A drawback of such an approach is that it, in effect, utilizes the debtor as a registry of notifications. In addition, the approach raises difficulties in the context of bulk assignments which might involve multiple debtors in several countries.

75. A rule based on registration would have the advantage that it would provide a system of notice to third parties, with the effect that the first assignee to register would have priority. Subject to the applicable insolvency law, the assignee would prevail over the assignor's creditors if the registration was effected before attachment, and over the insolvency trustee if registration was effected before the opening or effect of the insolvency proceedings (draft article 15(1), Variant C). Registration could be effected in existing national registries, e.g., those for secured transactions or for registration of companies, with information being made available internationally. Alternatively, registration could be effected in an international registry.

76. Registration might be simplified if: a summary standard statement of the assignment were to be registered (not the assignment itself, which would raise the problem of authorization); statements would indicate the identity of the assignor and the assignee, and would contain some reasonable description of the receivables (e.g., assignment from A to B of all receivables A has against X, Y, Z); registration could relate to future receivables, and it could take place before the receivables financing contract is concluded, in order to address the situation in which a third party might register its claim as to the receivables during the time between the conclusion of the contract and the registration by the assignee and thus obtain priority; the assignee would be able to register the assignment without the consent of the assignor being necessary (again the problem of authorization and the time and cost involved would be avoided).

77. One possible disadvantage of a registration-based solution is that existing registries may not be suitable, a circumstance which might require the establishment of a new registry. Another possible disadvantage might be that with the growing importance of bulk assignments, which can only be described in general terms, and of non-notification assignments, the usefulness of registration might be reduced. It may be felt, however, that, despite these possible drawbacks, a registration system would still provide more certainty and predictability than any of the other approaches mentioned above.

78. Another alternative would be a private international law rule based on the assignor's place of business (draft article 14(1), Variant D). [9] This rule would have the advantage that it could apply

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[9] Such a rule would not present the disadvantages of the rule proposed during the Diplomatic Conference in the context of which the Factoring Convention was adopted. There would not be a "superior right" provision; the issue whether the assignee is a factor would not be raised; and all the national systems under which priority might be determined would be covered (see CONF.7/6 Add.2, article Z. Priorities, and UNIDROIT 1988 CONF.7/C.1/S.R.19).

to the trustee in the assignor's insolvency proceedings opened at the place of business of the assignor. If the insolvency proceedings took place in another State, the rule would also apply, provided that that jurisdiction had adopted the draft uniform rules. In addition, such a rule would provide a single point of reference -- one that could be ascertained at the time of even a bulk assignment of future receivables and that would be suitable to legal systems where registration was practiced, since in such jurisdictions assignees would normally look to the place of business of the assignor to ascertain the status of receivables. However, priorities may be characterized variously, as issues of contract, tort, property, insolvency, or as procedural law, and thus may be subject to other applicable law. The problem of characterization may be overcome somewhat if the law of the country where the debtor has its place of business were applicable (see paragraph 73).

79. Whatever the priority rule might be, some exceptions may have to be made to address special cases such as the rights of the seller who retains title to the property sold until full payment of its price and who, at the same time, is the assignee of the future proceeds that might arise from the further sale of the property by the buyer in the course of its business (draft article 14(2)).

80. "Draft article 14. Priorities

(1) Variant A

The first assignee has priority over subsequent assignees, the assignor's creditors [and, subject to the applicable insolvency law, over the trustee in the insolvency of the assignor] with regard to the assigned receivables.

Variant B

The first assignee to notify the debtor in accordance with article 9 has priority over subsequent assignees, over earlier assignees who failed to notify or notified later, over the assignor's creditors [and, subject to the applicable insolvency law, over the trustee in the insolvency of the assignor] with regard to the assigned receivables.

Variant C

The first assignee to register a summary statement at a public register located in the place of business of the assignor, which reasonably identifies the assignor, the assignee and the assigned receivables, has priority over subsequent assignees and earlier assignees who failed to register or registered later, the assignor's creditors [and, subject to the applicable insolvency law, over the trustee in the insolvency of the assignor] with regard to the assigned receivables.

Variant D

The first assignee, or the first assignee to notify the assignment to the debtor, or the first to register a summary statement thereof in a public registry will have priority over subsequent assignees and the assignor's creditors, depending on the law of the State where the [assignor] [debtor] has its place of business.

(2) The rule of paragraph (1) does not apply in the following cases:

....."

I. Subsequent assignments

81. Subsequent assignments are assignments of the same receivables effected by the assignor subsequent to the first assignment, or by the first or any subsequent assignee. A number of questions might be considered, including: whether any subsequent assignee is to be treated as the first assignee (e.g., whether a subsequent assignee could validly make a bulk assignment of future receivables despite a no-assignment clause); whether all subsequent assignments would be covered, provided they fall under the rules, or only those of which the initial assignment was covered (draft article 15(1)); see also article 11 of the Factoring Convention); whether the debtor could setoff against a subsequent or the final assignee, claims which it might have against an earlier assignee, irrespective of whether they arise from a contract, from tort or by operation of law (draft article 15(3)); whether the assignor or any of the assignees could prohibit or restrict subsequent assignments (in particular in case of assignments by way of security or assignment of single receivables; draft article 15(4)); and whether the invalidity of an intermediate assignment would render any subsequent assignment invalid (the remedies of the assignee against the assignor for breach of the warranty of existence of the receivables and the right of the debtor to pay the final assignee and be discharged presumably would be preserved; draft article 15(5)).

82. "Draft article 15. Subsequent assignments

(1) These rules apply to any assignment of the same receivables by the assignor to several assignees or by the first or any other assignee to subsequent assignees, provided that the [first] [such] assignment is governed by these rules.

(2) In case of subsequent assignments by the assignor, the debtor is discharged from liability by payment to the first assignee to notify under article 9 and has against the assignee the defences provided for under article 10.

(3) In case of subsequent assignments by the first or any subsequent assignee, the provisions of articles 9 to 12 apply as if the subsequent assignee were the first assignee. However, the debtor may not assert against a subsequent assignee rights of setoff in respect of claims existing against an earlier assignee.

(4) Any subsequent assignment by the first assignee or by any subsequent assignee shall be effective notwithstanding any agreement between the first assignor and the first assignee or between any of the subsequent assignees prohibiting or restricting such assignment.

(5) Subject to the provisions of article 9, the invalidity of an intermediate assignment renders the final assignment invalid."

CONCLUSION

83. The above survey of obstacles that arise from disparity of law to the use of assignment of receivables for financing purposes, along with a first attempt at draft uniform rules to address those obstacles, would seem to suggest not only the desirability of work by the Commission in this area, but also its potential feasibility. The Commission may wish at this stage to assign the topic and the draft uniform rules to a working group for further work and development.

84. As envisaged in the present report, in broad terms the aim of work by the Commission would be to remove obstacles to receivables financing arising from the uncertainty existing in various legal systems as to the validity of cross-border bulk assignments of future receivables between the assignor and the assignee and the effects of such assignments on the debtor and other third parties. This would involve addressing by a set of uniform rules issues including the right of the assignee to demand payment, the duty of the debtor to pay and the related protection of the debtor, as well as priorities among competing creditors.

85. As to the form that work by the Commission may take, an eventual question to be considered is whether, in order to better promote recognition and enforcement of cross-border assignments, the work by the Commission might take the form of a convention, which would provide a network of countries in which cross-border assignments could be enforced. A related question would be whether such an instrument should be predominantly of a mandatory nature, since it might not be appropriate to allow the assignor and the assignee to vary the legal regime under which receivables would be transferred as against the debtor and other third parties. At the same time, particularly in setting the scope of the work, the aim would also be to take account of the important role played by party autonomy in the development of receivables financing.

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