

# THE PRIORITY RULES OF THE UNITED NATIONS RECEIVABLES CONVENTION

## A COMMENT ON BAZINAS

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### I. INTRODUCTION

In his comprehensive summary of the provisions of the United Nations Convention on the Assignment of Receivables in International Trade<sup>1</sup> (the Convention), Spiros Bazinas<sup>2</sup> points out correctly that one of the significant features of the Convention is to make subject to the law of the assignor any priority conflict between the assignee of a receivable and third parties claiming an interest in the same receivable, including a trustee in the bankruptcy of the assignor.<sup>3</sup> The policy decision to turn away from more traditional approaches represents significant progress in the development of international commercial law and the harmonization of conflict-of-laws rules in the area of secured transactions. This comment will analyze the reasons for the adoption of this rule at the international level, as well as its practical implications.

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1. The United Nations Convention on the Assignment of Receivables in International Trade, *opened for signature* Dec. 12, 2002, G.A. Res. 56/81, U.N. GAOR, 56th Sess., U.N. Doc. A/RES/56/81 (2002), available at <http://www.uncitral.org/stable/res5681-e.pdf> (last visited Mar. 5, 2002); United Nations Convention on the Assignment of Receivables in International Trade, available at <http://www.uncitral.org/english/texts/payments/ctc-assignment-convention-e.pdf> (last visited Mar. 5, 2002) [hereinafter United Nations Convention on the Assignment of Receivables in International Trade; or the Convention].

2. Spiros Bazinas, *Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitization and Cross-Border Perfection*, 12 DUKE J. COMP. & INT'L L. 365, 381 (2002).

3. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 22.

The first section explains why any priority contest between competing claimants of the same receivable must be governed by a single law. The second section reviews the advantages and disadvantages of the solution retained by the Convention, namely, that the law applicable to priorities shall be that of the location of the assignor.<sup>4</sup> Finally, the third section examines how the conflict rule of the Convention would operate under certain scenarios likely to occur in commercial transactions.

Under the Convention, a person who transfers or creates a security over a receivable is called the assignor. The transferee or holder of the security is the assignee. The debtor is the person who owes payment of the receivable.<sup>5</sup> Under the U.S. Uniform Commercial Code (U.C.C.) and the Canadian Personal Property Security Acts, the corresponding terms are debtor (instead of assignor), secured party (instead of assignee), and account debtor (instead of debtor).<sup>6</sup> This comment employs the terms “assignor,” “assignee,” and “debtor,” attaching to such words their respective meaning under the Convention. Likewise, the expression “security right” is used herein to describe the North American concept of security interest. The term “state” in the Convention refers to a sovereign state or country. However, if a state has two or more territorial units in which different systems of law are applicable in relation to certain matters, any reference in the Convention to the law of that state means, with respect to such matters, the law in force in the applicable territorial unit.<sup>7</sup>

## II. A SINGLE GOVERNING LAW FOR PRIORITIES

A lender who provides credit on the security of receivables needs to ensure that its security will be enforceable against third parties. The commercial value of a security right depends on whether the

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4. The choice of law systems in effect in the United States and Canada generally point to the law of the location of the assignor for priority issues. See U.C.C. § 9-301 (1977); see also Personal Property Security Act of Ontario, R.S.O., ch. P-10, § 7 (1990) (Can.) [hereinafter OPPSA]. The Personal Property Security Acts of the other common law provinces have a similar provision. The same rule is also found in the Civil Code of the Province of Quebec, which is a civil law jurisdiction [hereinafter C.C.Q.]. See C.C.Q., art. 3105.

5. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 2.

6. U.C.C. § 9102(3) (1977); OPPSA, § 1.

7. For instance, if an assignor is located in Pennsylvania, a reference in the Convention to the law of the state in which the assignor is located means, *inter alia*, the U.C.C. in force in Pennsylvania. This is necessary in order for the Convention to work in federal states such as the United States and Canada where the applicable law is in many respects within the legislative authority of their territorial units.

holder of the right will be entitled to priority against competing claimants, such as another secured creditor, an unsecured creditor, a purchaser of the collateral, or a trustee in the bankruptcy of the borrower. The same need exists where receivables are financed through a sale to a factor or under a securitization program. Indeed, many legal systems contain specific provisions intended to solve a priority contest among several persons claiming an interest in the same receivable.<sup>8</sup> The absence of rules in this regard deters the use of receivables as collateral. The problem is compounded in an international transaction where there is uncertainty as to which law would apply to settle a potential conflict of priority between several persons purporting to have a right to the receivable.

The Convention therefore is a milestone in the development of international commercial law, as it permits an easy determination of the body of rules to be used to solve priority conflicts. Any conflict involving an international assignment or an international receivable would be resolved by referring to one single law, namely the law of the location of the assignor.<sup>9</sup>

This is a significant achievement for two main reasons. First, the private international law rules of many states do not provide clear guidance or have given rise to controversies as to the law governing a priority contest in relation to receivables. As pointed out by Mr. Bazinas, such is the case for the European states that are parties to the Rome Convention on Contractual Obligations.<sup>10</sup> Second, even in states with clear choice of law rules on the issue, the relevant rules might not always point to the same law in a situation in which the respective rights of the competing claimants are not of the same legal nature. For example, when the purchaser of a receivable competes with a lender holding security over the same receivable, it might be an insurmountable task for a court to settle a priority contest between the parties if the *lex fori* were to point to the law of state A to deter-

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8. See, e.g., U.C.C. § 9-322 (1977); OPPSA, § 30.

9. For the Convention to apply, at least one of the claimants must be an assignee of an international receivable or an assignee under an international assignment. Internationality is defined as follows: an assignment is international if the assignor and the assignee are located in different states; a receivable is international if the assignor and the debtor are in different states. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 3. A dispute between two domestic assignees with respect to a domestic receivable is outside the scope of the Convention and therefore is not governed by it. *Id.*

10. European Communities Convention on the Law Applicable to Contractual Obligations, *opened for signature* 19 June 1980, 1980 O.J. (L 266) 1, *reprinted in* 19 I.L.M. 1492 (1980). [hereinafter Rome Convention]. It is unclear whether Article 12 of the Rome Convention applies to a priority contest. Bazinas, *supra* note 2, at 381 n.69.

mine the rights of the purchaser and to the law of state B to determine the rights of the lender. If state A gives priority to the purchaser, while in a similar situation in state B the lender prevails, the court would face great difficulties in its efforts to resolve the dispute.<sup>11</sup> This example demonstrates the necessity of referring to one single law to determine priority between competing claimants to the same receivable, irrespective of the legal origin of each claimant's interest (i.e., a sale and a security right in the example). The Convention achieves that goal by defining "assignment" to include not only an outright transfer, but also a security right in a receivable, and in subjecting all priority contests involving assignees to the same law.<sup>12</sup>

The Convention will provide another benefit for states becoming parties thereto: the risks and costs resulting from discrepancies between the conflict-of-laws rules in effect in the world will be minimized with regard to those states. The following example illustrates those risks and costs and how they will be minimized by reason of the application of the Convention. A lender located in state A lends money to an exporter located in the same state on the security of a receivable owed to the exporter by a customer located in state B. If the choice of law rule for priorities in state A points to the law of the location of the assignor—state A, in the example—and if the lender takes all steps required to perfect its security under the laws of state A, this does not necessarily mean that the lender will be entitled to priority in state B. In the event of litigation in state B involving the lender and a third party attempting to garnish the receivable, a court of that state will look to its own conflict rules to ascertain the law applicable to the resolution of the dispute. If, under the conflict rules of the forum, the applicable law is that of state B, the lender will be unable to assert its priority in state B, unless it also has obtained a first ranking security under the domestic laws of state B. Therefore, a lender wishing to avoid the risks resulting from differences in conflict rules between different states must at present verify the conflict rules of all states where enforcement might take place. After having ascer-

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11. This situation might occur in a jurisdiction whose conflict rules were to direct the court to the law of the domicile of the debtor of the receivable to determine whether the purchaser has acquired good title to the receivable, but to the law of the domicile of the borrower (i.e., the grantor of the security) to determine the effectiveness of the security right acquired by the lender. Depending on the circumstances, a problem of such nature could arise under the Civil Code of Quebec which does not have, with respect to receivables, the same conflict rule for outright transfers and for security rights. *See* C.C.Q., arts. 3097, 3105, 3120.

12. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, arts. 2, 22.

tained the various laws applicable to priorities as determined by the conflict rules of those states, the lender will need to comply with the priority requirements of all such laws in order to be fully protected.

In a situation in which all states concerned were parties to the Convention, one single enquiry would suffice, since the conflict rules of all such states would direct the lender to the law of the location of the assignor. The lender then could rely on one single law to establish the priority of its security. As mentioned by Mr. Bazinas, the costs to the lender would be reduced.<sup>13</sup>

### III. THE LAW OF THE ASSIGNOR

The law of the location of the assignor has been selected by the authors of the Convention as the law applicable to priorities.<sup>14</sup> This section considers the reasons for that policy decision and for departing from more traditional solutions.

Traditionally, the choice of law rule for the effectiveness of a security right against third parties has been the law of the location of the charged asset (*lex situs*).<sup>15</sup> Although a rule based on the *lex situs* works well in most instances for tangible property, great difficulties arise in applying the *lex situs* to intangible property, both at conceptual and practical levels.

From a conceptual standpoint, there is no consensus, and no clear answer in many legal systems, as to the *situs* of a receivable. Is it the place where payment must be made, or the place of business or principal residence of the debtor of the receivable? Or, should a receivable be deemed to be located in the state whose law governs the contractual relationship between the original creditor (i.e., the assignor) and the debtor? Any of the foregoing alternatives would impose the burden of having to make a detailed investigation upon a

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13. Bazinas, *supra* note 2, at 381.

14. Note that the reference to the law of the location of the assignor refers to the domestic law of the jurisdiction in which the assignor is located, that is, excluding the conflict-of-laws rules of such jurisdiction. In other words, the Convention excludes the doctrine of *renvoi*. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 5(i).

15. For an excellent analysis of the traditional solutions and how the *lex situs* rule was perceived as being capable of application to intangibles, see the recent article by Catherine Walsh, *Receivables Financing and the Conflict of Laws: The UNCITRAL Draft Convention on the Assignment of Receivables in International Trade*, 106 DICK. L. REV. 159 (2001). In her article, Professor Walsh also reminds the reader that the Convention rule may be viewed as a revitalization in a modern form of the old maxim *mobilia sequuntur personam* (personal property follows the person).

prospective assignee. Moreover, in many instances, it might prove impossible to determine with certainty the exact location of a receivable since the criteria for determining that location may depend on the will of the parties to the contract under which the receivable arises. Thus, using the *lex situs* as the law applicable to priority issues involving receivables would not provide certainty and predictability, which are key objectives for a sound conflict-of-laws regime in the area of secured transactions. Furthermore, even if the Convention had adopted detailed provisions allowing a prospective assignee to ascertain easily and objectively the law of the location of a receivable, practical difficulties would have ensued in many commercial transactions if such law had been selected as the law applicable to priority issues.

The Convention applies not only to the assignment of an existing and specifically identified receivable but also to any other kind of assignment.<sup>16</sup> Thus, an assignment may relate to a pool of present and future receivables. In such a case, selecting the *lex situs* as the law governing priorities would not be an efficient policy decision: different priority rules might apply with respect to the various assigned receivables. Moreover, where future receivables are included in an assignment, it would not be possible for the assignee to ascertain the extent of its priority rights at the time of the assignment, since the *situs* of those future receivables is unknown at such time.

Therefore, the law of the location of the assignor appears to be the best choice of law rule in order to achieve predictability and cost-savings. The Convention defines the location of a person as follows:

A person is located in the State in which it has its place of business. If the assignor or the assignee has a place of business in more than one State, the place of business is that place where the central administration of the assignor or the assignee is exercised. If the debtor has a place of business in more than one State, the place of business is that which has the closest relationship to the original contract. If a person does not have a place of business, reference is to be made to the habitual residence of that person . . .<sup>17</sup>

This definition corresponds with the provisions in force in some legal systems, which consider an assignor as being located in the state in

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16. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 9.

17. *Id.* art. 5(h). This Article defines not only the location of the assignor but also the location of the assignee and the debtor. As a result, the definition also serves to determine the scope of application of the Convention (i.e., the assignor must be in a contracting state and the assignment or the receivable must be international). *See supra* note 9.

which it has its place of business, or, if it has more than one place of business, in the state in which it has its chief executive office.<sup>18</sup> The place of central administration and the place of the chief executive office coincide in most instances.<sup>19</sup> However, a legal entity's central administration might be located in a place different from that of its registered office or statutory seat.<sup>20</sup> For instance, a corporation incorporated in Canada with a registered office in Montreal could have its place of central administration, or chief executive office, in New York City.

While it might have been easier to ascertain the location of a corporate assignor by providing that a corporation is deemed to be located in the state in which it has its registered office,<sup>21</sup> or in the state under the law of which it is incorporated,<sup>22</sup> many countries participating in the elaboration of the Convention opted against such definitions. They, instead, were of the view that those criteria do not reflect the reasonable expectations of the parties when the center of management and control of a corporation is in a jurisdiction other than the jurisdiction in which its registered office is situated, or under the law of which it is incorporated. The place of central administration test was retained as a good compromise between the need for certainty and the desire to select a place with some substantial connection to the assignor.<sup>23</sup>

When a multinational corporation with senior executive officers based in two or more states is the assignor, it may prove difficult to determine conclusively the exact location of the assignor. Nonetheless, to the extent that all relevant states would be parties to the Con-

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18. This is the case under the Canadian Personal Property Security Acts. *See, e.g.*, OPPSA, § 7. The U.C.C. also places certain non-US assignors at the location of their chief executive office. *See* U.C.C. § 9-307 (1977).

19. The Rome Convention uses the term "place of central administration." Rome Convention, *supra* note 10, art. 4.

20. In some international conventions, the term "statutory seat" is used as an expression similar to "registered office." *See, e.g.*, Convention on International Interests in Mobile Equipment, Nov. 16, 2001, art. 4, *available at* <http://www.unidroit.org/english/internationalinterests/conference2001/main.htm> (last visited Apr. 12, 2002).

21. As is the case in the Civil Code of Quebec. *See* C.C.Q., arts. 307, 3105.

22. This is the case under the U.C.C. for registered organizations that are organized under the law of a state of the United States. *See* U.C.C. § 9-307(e) (1977).

23. *See, e.g.*, *Report of the Working Group on International Contract Practices on the Work of its thirty-first session*, UNCITRAL, 34th Sess., U.N. Doc. A/CN.9/466 (1999); *Receivables Financing: Analytical Commentary to the draft Convention on Assignment [in Receivables Financing][of Receivables in International Trade]*, UNCITRAL, 34th Sess., U.N. Doc. A/CN.9/470 (2000), both documents *available at* <http://www.uncitral.org/en-index.htm> (last visited Apr. 8, 2002).

vention, every claimant would know that in each such state the law applicable to priority issues is the law of the location of the assignor. A prudent assignee could then perfect its right complying with the perfection requirements of each state in which the assignor might be considered as having its place of central administration. Of course, the foregoing comment assumes that the assignment will remain within the scope of the Convention irrespective of the place where the location of the assignor might be.

On the other hand, when it is unclear if the assignor is located in state A or in state B, the Convention might not necessarily apply in both cases. Suppose the assignee and the debtor are located in state B. In such a case, the Convention would not apply if the court were to make a finding of fact that the place of central administration of the assignor was also in state B. In effect, the assignment would then be outside the scope of the Convention (i.e., assignor, debtor, and assignee being all located in state B within the meaning of the Convention). Therefore, a prudent assignee also would need to verify the internal conflict-of-laws rules of state B in order to determine under those rules what law governs priorities issues, which law might not be the law of the state where the assignor has its place of central administration. Indeed, the additional burden imposed on an assignee in such a scenario would be eliminated if state B, concurrently with the ratification of the Convention, were to align its “general” conflict-of-laws rules on assignments with those provided by the Convention.

#### IV. PRACTICAL APPLICATIONS

This section examines the way the Convention would work in certain scenarios likely to occur in commercial transactions. For simplicity's sake, each scenario assumes that all states in which the assignee might need to assert its priority are parties to the Convention. The term “perfection” is used in the examples below to describe all requirements that have to be satisfied to render an assignment effective against third parties, and to establish the priority of the right of the assignee. The definition of priority in the Convention is broad and includes the determination of whether these requirements have been satisfied.<sup>24</sup> Accordingly, the reference in the Convention to the law of the assignor as the governing law for priorities must be construed as including perfection issues.

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24. See United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 5(g).

### Example 1

On day one, A, a manufacturer with places of business in Canada and the United States, assigns all of its present and future receivables to Bank B. The assignment secures a line of credit made available to the manufacturer by a branch of Bank B located in the province of Quebec, in Canada. The manufacturer has its place of central administration in the province of Quebec, but is incorporated and has its registered office in the state of Delaware. Bank B has its place of central administration in the province of Quebec. Bank B perfects its assignment under the laws of the state of Delaware and, accordingly, makes the filing required by the Uniform Commercial Code of Delaware. A search in Delaware reveals no other entry against A's name.

On day two, the manufacturer assigns to C, a bank whose place of central administration is in New York City, a pool of receivables arising under a supply agreement with D, a corporation whose sole place of business is in the state of New York. The assignment secures a loan made by Bank C to finance the manufacturing by A of the goods sold to D under the supply agreement. Bank C perfects its assignment under the laws of the province of Quebec and a filing against A's name is made in the Quebec registry for security rights. No other entry appears in the registry in relation to A.

In the event of a priority contest between B and C with respect to the receivables owed by D, C will prevail. The receivables are international because the assignor and the debtor are located in different states within the meaning of the Convention: the assignor's place of central administration is in Canada and the debtor's sole place of business is in the United States. The Convention, therefore, applies to the priority contest between the two assignees with the result that the law of the location of the assignor, namely, the law of the province of Quebec, determines who is entitled to priority. Since Bank C has perfected its assignment under the laws of the province of Quebec but Bank B has not, Bank C will prevail over Bank B.

It is noteworthy that Bank C will prevail despite the fact that under the internal conflict-of-laws rules of both the province of Quebec and the state of New York, the law applicable to priority would have been the laws of Delaware. The conflict rules of the Convention displace the internal conflict-of-laws rules of the countries that are parties to the Convention.<sup>25</sup>

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25. For a comprehensive review of the differences in assignor-location rules between the Convention and U.C.C. Article 9, see the recent article by Harry C. Sigman & Edwin E. Smith,

### Example 2

In this example, the fact pattern is the same as in example 1, except that D, the debtor, has its sole place of business in the province of Quebec.

Under this new scenario, the assignment between A and B is not per se governed by the Convention insofar as it relates to the receivables owed by D: the location of each of A, B, and D is in the province of Quebec within the meaning of the Convention, with the result that neither the assignment nor the receivables owed by D are international. As previously mentioned, for the Convention to apply to an assignment, either the assignment or the assigned receivables (or both) must be international; that is, the parties to the assignment or to the contract under which the receivable arises must be in different states.

Nonetheless, a dispute between Bank B and Bank C will be settled in the same manner as in example 1: C will have priority over B. This is so because the assignment between A and C is an international assignment (A being located in Canada and C being located in the United States) with the consequence that C is entitled to rely on the Convention to establish its priority right. B is a competing claimant in relation to assignee C and the Convention defines a competing claimant as including another assignee whose assignment would not otherwise be subject to the Convention.<sup>26</sup> In other words, in the case of priority contest between two assignees, the priority provisions of the Convention govern if at least one of the two assignments is an assignment to which the Convention applies.

Therefore, in example 2, the priority provisions of the Convention will point to the law of the province of Quebec (that is, the law of the location of the assignor). In the example, Bank C has taken all steps required to perfect its assignment, including filing a notice of its assignment in the Quebec filing system for security rights. Therefore, Bank C will prevail over Bank B, given that Quebec law grants priority in a scenario like this to the claimant who is first to file in Quebec

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*Toward Facilitating Cross-Border Secured Financing and Securitization: An Analysis of the United Nations Convention on the Assignment of Receivables in International Trade*, 57 BUS. LAW. 727 (2002).

26. See United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 5(m).

### Example 3

On day one, a bank, whose place of central administration is in Germany, lends money to a manufacturer also with its place of central administration in Germany. As security for the repayment of the loan, the manufacturer executes in favor of the bank an assignment of a receivable owing to the manufacturer by a customer located in Pennsylvania. Nothing else is done by the German bank to establish its priority right, assuming, for the purposes of the example, that the law in Germany states that a first in time assignee prevails over a subsequent assignee without any need to register the assignment or to notify the debtor.

On day two, the manufacturer, through its Philadelphia office, sells the same receivable to a factor located in Pennsylvania; on the same day, the factor perfects its assignment in Pennsylvania and in the District of Columbia and makes the appropriate filings under the laws of these jurisdictions. Searches show no other filing against the name of the manufacturer.

On day three, a priority contest arises between the two assignees. Who wins? According to the Convention, the German bank has priority over the American factor because, under German law, a first in time assignment ranks ahead of a subsequent assignment. The fact that the German bank's assignment has not been perfected under the law applicable to such issue in Pennsylvania or the District of Columbia is not relevant: the Convention specifies that the governing law for priorities is the law of the state in which the assignor is located,<sup>27</sup> Germany in the above scenario.

This example may serve as a reminder that the application of the law of the jurisdiction of the assignor is not conditioned on such jurisdiction having a public filing or recording system for security rights.<sup>28</sup> In the example, the Convention would direct the court to apply German law, even if German law does not provide for public registration or recording of assignments of receivables.

## V. CONCLUSION

Although wide in its scope, the Convention does not apply to each and every kind of receivable. Certain types of financial receivables are excluded, such as receivables arising from bank deposits and

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27. *Id.* art. 22.

28. Such a condition is required by the U.C.C. for the law of a jurisdiction outside of the United States to apply. *See* U.C.C. § 9-307(c) (1977).

securities entitlements.<sup>29</sup> These exclusions reflect the school of thought that bank deposits and securities entitlements merit special treatment and should not be governed by the law of the location of the assignor. Moreover, subjecting securities entitlements to the Convention would have led to a result inconsistent with the rule proposed for securities entitlements by the draft Hague Conference Convention on indirectly-held securities: the proposed conflict rule for priority issues involving indirectly-held securities is the law of the place of the relevant securities intermediary.<sup>30</sup>

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29. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 1, art. 4.

30. The most recent draft can be found on the website of The Hague Conference on Private International Law. See Preliminary draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, adopted by the Special Commission, Jan. 17, 2002 (Prel. Dec. No. 8 of Feb. 2002), available at <http://www.hcch.net/e/workprog/securities.html> (last visited Apr. 12, 2002).