UNCITRAL'S RECEIVABLES CONVENTION: THE FIRST STEP, BUT NOT THE LAST

A COMMENT ON BAZINAS

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I. INTRODUCTION

In *Multi-Jurisdictional Receivables Financing: UNCITRAL's Impact on Securitization and Cross-Border Perfection*,[1] Spiros Bazinas gives us a masterful summary of the potential benefits of the new Convention on the Assignment of Receivables in International Trade[2] (the Convention) for securitization. Moreover, he has collected references to many of the commentaries on early drafts of the Convention. In the face of such a complete and worthwhile job, there is little to add by way of detail.

There may be, however, room to enumerate the hurdles that the Convention must still surmount. Among these are the effort to introduce not just different legal concepts to different legal systems, but concepts that, in some respects, are contrary to the current law of those systems. In addition, the Convention is a sophisticated legal document, finely crafted after many years of debate, and well drafted by Mr. Bazinas. As such, however, the Convention may be difficult to

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

2. United Nations Convention on the Assignment of Receivables in International Trade, *opened for signature* Dec. 12, 2001, 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].

incorporate into domestic legal regimes that are not accustomed to such detailed legislative drafting. These concerns might be labeled procedural, but I think that they stand as practical impediments to the full realization of the Convention's goals. Among other things, they indicate the need for a concentrated effort to ensure that states appreciate the importance of the Convention and adapt their domestic legal systems to incorporate its terms.

In this comment, I highlight some of the more radical changes that adoption of the Convention would bring about for various legal systems and examine what types of preparation should be made to accommodate and receive such changes. In addition, I comment on the legal systems most in need of the type of financing that should be utilized subsequent to the Convention's adoption, and what such systems must do before the Convention can succeed. None of this, however, should detract from the luster of the Convention; it is more an exploration of the next phase of the Convention's life.

II. CHANGES APLENTY—FOR BOTH CIVIL AND COMMON LAW SYSTEMS

The Convention tries to bring order to a variety of different legal treatments of the assignment of receivables. The basis of the differing treatments is more than superficial; it is not an exaggeration to say that civil law and common law approaches to security radically differ from, or even contradict, each other at significant points. In this section, I will discuss some significant changes that civil law nations would be required to make, and then conclude with changes that will be necessary in some common law nations, including the United States.

A. Civil Law

The Civil Law generally has not looked expansively on the assignment of intangibles such as receivables. In particular, the laws of many civil law countries do not permit assigning receivables in bulk,[3] the assignment of receivables not yet in existence,[4] nor do they recognize a transfer unless the person obligated on the receivable (the debtor) receives notice of the transfer.[5] Furthermore, a transfer for

3. That is, an assignment that does not specify the debtor or other facets of the debt. A typical bulk assignment could read: "X transfers all receivables owed to it on this date to Y."

4. This would occur if the grant were something like "X transfers to Y all receivables now owed *or hereafter arising*."

security of a right to payment will be invalidated if the underlying contract contains an anti-assignment clause.[6]

Under current practices, these restrictions can limit the financing opportunities available to many companies. The costs associated with describing every receivable definitively upon its creation and so notifying the debtor, may significantly impact the cost of credit, by multiplying the administrative work necessary to ensure an effective transfer. This can be detrimental to credit, in that it would require the borrower and debtor to create new agreements each time a receivable, or batch of receivables, arose, thus greatly increasing administrative costs. This is unfortunate since receivables are a very desirable form of credit, and with the emergence of companies based upon information technology, may be one of the few types of collateral that financing institutions will be willing to lend against.

The Convention has tried to address these limitations. Although the Convention is primarily what Americans refer to as a "choice of law" convention,[7] it does seek to change the substantive law, regarding the transfer of receivables, of states which sign or ratify the Convention.[8] Article 8 of the Convention states, in relevant part:

Article 8

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5. Under the nomenclature adopted by Article 2(a) of the Convention, the typical assignment has three parties: the assignor, the assignee, and the debtor. The assignor is the entity to whom the receivable is owed; in financing transactions, it would be the borrower, and in securitization transactions it would like be the originator. The assignee is the entity to whom the receivable is transferred; in financing transactions, it would be the lender, and in securitizations it would likely be the special purpose vehicle (SPV). The debtor is the entity who owes payment on the receivable. *See* United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 2.

Financing practice in the United States and Canada uses different terms. Under American and Canadian practice, the debtor is an "account debtor," the assignor is a "debtor," and the assignee is a "secured party."

6. *See generally* JOHN H. MERRYMAN, THE CIVIL LAW TRADITION: EUROPE, LATIN AMERICA AND EAST ASIA 1169 (1994); PHILIP R. WOOD, COMPARATIVE LAW OF SECURITY AND GUARANTEES § 4-5 (1995); Ulrich Drobnig, *Secured Credit in International Insolvency Proceedings*, 33 TEX. INT'L L.J. 53, 60 (1998); Richard Walsh, *Pacific Rim Collateral Security Laws: What Happens When the Project Goes Wrong?*, 4 STAN. J.L. BUS. & FIN. 115, 124–25 (1999).

Mr. Bazinas recognizes these limitations, and as authority for their existence, he cites Hein Koetz, *Chapter 13*: *Rights of Third Parties. Third Party Beneficiaries and Assignment*, *in* 7 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW (1992). *See* Bazinas, *supra* note 1, at 371 n.25.

7. Non-Americans would call it a "private international law" convention.

8. In this regard and throughout this article, I use "state" in the international sense to refer to a country or a nation. I do not mean one of the fifty separate political units referred to as "states" in the United States.

Effectiveness of assignments

1. An assignment is not ineffective as between the assignor and the assignee or as against the debtor or as against a competing claimant, and the right of an assignee may not be denied priority, on the ground that it is an assignment of more than one receivable, future receivables or parts of or undivided interests in receivables . . . .

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2. Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable . . . .

The Convention also indicates that while an anti-assignment clause may be valid for the purposes of assessing damages between the assignor and the assignee, it will not prevent the assignor's alienation of its right to receive payment from the debtor.[9]

The Convention, however, does not address directly the debtor's notification requirement. Article 2(a) seems to define an assignment definitively, without mentioning the necessity of notice.[10] If Article 2(a)'s definition is followed, the assignment process will be streamlined, and securitizations will benefit from the elimination of any requirement that the debtor be notified. Such notification, for example, would be fatal to the mass securitization of credit card receivables or car loan receivables.

These changes effectively will modify, and in some respect alter completely, the laws of adopting states. But they accomplish their task in an odd way, as discussed below. Given that the Convention only purports to cover receivables that are international in some sense, or at one point were international,[11] every borrower/assignor will be able to have two classes of receivables, each with its own different rules with respect to validity. For example, a vehicle manufacturing company could securitize its lease receivables with a foreign special purpose vehicle (SPV) and thus have the Convention apply. It

9. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 9.

10. *Id*. art. 2(a).

11. *Id*. art. 1. The Convention covers international assignments of receivables (those transactions in which the assignor and assignee are located in different states), and assignments of international receivables (those transactions in which the debtor and the assignor are in different states). *Id.* In addition, however, the Convention will apply for all time to any receivable once it is under the Convention. If, for example, a receivable is covered by the Convention because the person to whom the money is owed assigns the receivable to a foreign bank, and that bank later assigns the receivable to a bank in the same country as the original assignor (thus locating all three parties in the same jurisdiction), the Convention will still apply. *Id*. art. 1(b).

could then securitize its sales receivables with a domestic bank, and thus have domestic law apply.

If managed adroitly, this could have the salutary effect of bringing domestic law more into line with the Convention's more modern principles. However, if the domestic legal system does not have the capacity to manage the new differences between domestic and international receivables, it will also likely inject uncertainty into an insolvency of any sophistication.

B. Common Law

There are also some changes in store for common law jurisdictions that ratify the Convention. These jurisdictions typically adopt a property, or an *in rem*, approach to transactions entered into for purposes of security.[12] The Convention harmonizes this approach with other *in personam* systems, in which priority of payment is the essence of security. The one area in which this harmonization requires some changes is that of proceeds.[13]

Briefly stated, in common law systems, the secured creditor has a property right not only in its original collateral, but also in the proceeds of sale or other disposition of that collateral.[14] Thus, if a manufacturing company sold a forklift that was subject to a security interest, absent the secured party's consent, the secured party's security interest would not only continue in the forklift itself, but would also extend automatically to the compensation or sales prices received by the seller, such as the check used to pay for the forklift.[15]

The Convention does not carry this level of protection to the receivables it covers. Refraining from specifying the law that will de-

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12. *See, e.g.*, U.C.C. § 1-201(37) (2000); British Columbia Personal Property Security Act, R.S.B.C., ch. 36, §1(1) (1989) (Can.); Michael G. Bridge et al., *Formalism, Functionalism, and Understanding the Law of Secured Transactions*, 44 MCGILL L.J. 567 (1999) (discussing the differences between common law and other systems). *See generally* Ronald C.C. Cuming, *Harmonization of the Secured Financing Laws of the NAFTA Partners*, 39 ST. LOUIS L.J. 809 (1995) (discussing the harmonization of U.S. and Canadian secured financing law).

13. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 5(j) (defining proceeds as "whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods.").

14. *See, e.g.*, U.C.C. § 9-203(f) (2000).

15. *See, e.g.*, U.C.C. § 9-315(a) (2000); Personal Property Security Act of Ontario, R.S.O., ch. P-10, § 25(1)(b) (1990) (Can.); British Columbia Personal Property Act, R.S.B.C., ch. 36, § 25(1)(b) (1989) (Can.).

cide priority, and deciding priority as a substantive matter, the Convention defines "priority" as follows:

> (g) "Priority" means the right of a person in preference to the right of another person and, to the extent relevant for such purpose, includes the determination whether the right is a personal or a property right, whether or not it is a security right for indebtedness or other obligation and whether any requirements necessary to render the right effective against a competing claimant have been satisfied . . . .[16]

The Convention then tackles priority in proceeds in Article 24. That Article states:

> Article 24
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> Special rules on proceeds
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> 1. If proceeds are received by the assignee, the assignee is entitled to retain those proceeds to the extent that the assignee's right in the assigned receivable had priority over the right of a competing claimant in the assigned receivable.
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> 2. If proceeds are received by the assignor, the right of the assignee in those proceeds has priority over the right of a competing claimant in those proceeds to the same extent as the assignee's right had priority over the right in the assigned receivable of that claimant if:
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> (a) The assignor has received the proceeds under instructions from the assignee to hold the proceeds for the benefit of the assignee; and
>
> (b) The proceeds are held by the assignor for the benefit of the assignee separately and are reasonably identifiable from the assets of the assignor, such as in the case of a separate deposit or securities account containing only proceeds consisting of cash or securities.

Article 25(1) of the Convention clearly preserves the choice of law focus. It states that if proceeds actually are obtained and held by the assignee—the lender—then that assignee can hold only them against those whom it could resist under applicable local law. If that applicable local law were Revised Article 9 of the Uniform Commercial Code (U.C.C.), then the assignee would prevail if that assignee had previously taken steps to perfect its interest in the original receivable.[17] Under Revised Article 9, if the assignee has a perfected security interest in the original collateral, the assignee would have priority

16. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 5(g).

17. U.C.C. § 9-317(a)(2) (2000) (perfected security interest has priority over interest of judicial lien creditor); U.C.C. § 9-315(c) (2000) (perfection in collateral creates perfected security interest in proceeds of that collateral).

over competing judicial lien creditors at least for 20 days, and probably longer.[18]

If the assignor/borrower obtains the proceeds, the test is essentially the same—the local law providing the rule of priority—although there is a safe harbor. The lender/assignee prevails, if the assignor/borrower holds the proceeds on the lender's instructions and in a segregated manner. This structure will facilitate securitization in that it will be easy for the SPV to either direct the proceeds of receivables to be remitted to it (or a lock box it controls), or if the SPV structures the transaction so that the proceeds of receivables are held in a segregated account by the borrower/assignor.

In any event, the protection for lenders would appear to be less than that which is provided by U.C.C. Revised Article 9 or other personal property statutes extant in common law countries, if only from the additional requirements specified in the case of retention of the proceeds by the borrower/assignee.[19] If enacted in the United States, for example, the Convention would preempt U.C.C. Article 9, and again provide for a dual system of enforcement—one for domestic receivables, and one for receivables subject to the Convention.

Finally, the Convention may require that changes be made to U.S. bankruptcy law. Under current law, the transfer of a receivable subject to a blanket grant of a security interest in future receivables arises only when the receivable is actually created, regardless of whether it is earned.[20] Moreover, U.S. bankruptcy law disables the grant of a security interest in an after-acquired receivable from and after the filing of the bankruptcy petition.[21] This provision is intended to ensure that the secured creditor is not enriched at the expense of unsecured creditors without any provision of new value.[22]

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18. U.C.C. § 9-315(d) (2000). The security interest will be automatically perfected for twenty days, and then will continue if one of several conditions are met. U.C.C. § 9-315(d)(1)–(3) (2000).

19. In addition, if the assignor/originator in a securitization transaction diverted the funds intended for the segregated accounts, the SPV, as secured party, could trace the funds and claim them, or items purchased with them. Under the Convention, it is not clear whether such a diversion would give rise to a claim under the Convention, although it may very well give rise to some *in rem* claim under local law.

20. A security interest does not arise until it is attached, and it cannot attach until the debtor/borrower has "right in the collateral." U.C.C. § 9-203(b)(2) (2000). In addition, for preference purposes under United States bankruptcy law, a transfer occurs only when the "debtor has acquired rights in the property . . . ." 11 U.S.C. § 547(e)(3) (2000).

21. 11 U.S.C. § 552(a) (2000).

22. The provision has an exception to the extent that the claim to the post-petition can be characterized as "proceeds" of a pre-petition security interest. *Id.* § 552(b).

The Convention could change this state of affairs. Under the Convention, states can declare any one of five different priority schemes: three different schemes based on first to register an interest; one based on first to conclude the contract of assignment; and another based upon the time of notice to the debtor on the contract assigned.[23] Conversely, states may not necessarily make any declaration at all.[24] These provisions are presumably for states in which the system of secured credit has not yet matured, in that they present as options a series of priority systems currently in use throughout the world. It is possible that a state with a mature legal system in place might switch, but that seems unlikely given the reliance often placed in allocation of such rights by citizens of such mature systems.

States may think that one of the options represents their system, and make declarations adopting that selected option accordingly. Selecting an option under Article 42 may be more difficult, however, than it first appears. Often, a state's law of priority is not found exclusively in one statute, as illustrated by the paradigm of a separate bankruptcy statute and a separate secured credit statute.[25] The Convention, however, does not purport to change anything but the secured credit statute. As a consequence, if states are not careful in making their declarations under Article 42, subtle changes in domestic law may occur.

I can construct an example based upon U.S. bankruptcy law. Under the Convention, a receivable arguably is deemed transferred at the moment the contract of assignment is concluded.[26] Priority, at least under several of the options in Article 42, dates from the date of that assignment's registration. At least under some of the methods of priority set forth in the Convention, a lender/assignee thus would have priority in a future receivable arising after the insolvency of the borrower/assignor, so long as the original contract of assignment provided for such future receivables and so long as the original contract of assignment had been concluded. As pointed out above, this re-

23. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 42.

24. Nothing obligates a signatory state to make a declaration, and paragraph 4 of Article 42 even allows such a non-declaring state to use, if it wishes, any registry created under the Convention. *Id.* art. 42(4).

25. The United States is a key example. Its bankruptcy law is federal, while the majority of its secured credit law is state law, which adopts Article 9 of the U.C.C. *See* 11 U.S.C. §§ 101, *et. seq*. (2000).

26. United Nations Convention on the Assignment of Receivables in International Trade, *supra* note 2, art. 2(a).

sult—that the lender would have a security interest in post-filing receivables—contradicts U.S. domestic law,[27] but the conclusion would not be obvious. States will have to make their declaration with extreme care to avoid unnecessarily disturbing policies embodied in their other laws.

III. THE GROUNDWORK NECESSARY FOR THE CONVENTION'S EFFECTIVE IMPLEMENTATION

That a sensible adoption of the Convention will require significant study introduces my last point about the Convention. The Convention is, as might be expected from a long effort involving many educated representatives from diverse legal systems, a complex and intricate document. It is not a document that can be adopted blindly. I question whether any such document, not just the Convention, can be adopted by many emerging legal systems to the full extent to which it was intended.[28]

Indeed, even if the necessary study is undertaken, any law enacted subsequently will be only as effective as those who work with it and those who are asked to enforce obligations arising under it. The quality and experience of a judiciary will be important.[29] Yet as recent events have shown, the level of fidelity to the text of the law and the tolerance toward corruption[30] stand as impediments to any good faith law reform effort.[31] In Indonesia, for example, the introduction

27. *See supra* note 22.

28. In these observations, I draw upon my experience in Indonesia, the fourth most populous country in the world. *See generally* Bruce A. Markell, *A View From the Field: Some Observations on the Effect of International Commercial Law Reform Efforts on the Rule of Law*, 6 IND. J. GLOBAL LEGAL STUD. 497 (1999) (describing the connection between the rule of law and commercial law in the global era based on experiences in the field of commercial law in Indonesia).

29. Indonesia recently experienced trouble with the introduction of modern financial concepts, which caused a highly respected Indonesian attorney to note that "the complex structure of international finance and its terminology such as events of default, acceleration of debt maturity, syndicated loans, commercial papers, forward transactions and derivatives were very new and incomprehensible to the country's [new] commercial court." *Criminal Court Needs Modernization*, THE JAKARTA POST, Jan. 29, 1999, at 1 (quoting Kartini Muljadi of Kartini and Partners).

30. An emerging measure of corruption within a state is the Corruptions Perceptions Index, published by Transparency International, *available at* http://www.transparency.org/cpi/index.html (last visited Apr. 12, 2002).

31. There may even be disagreement about how best to interpret texts. In Indonesia, for example, a minor scandal erupted when several judges refused to take their oath of office until they had the right to write a publicly-available dissent. Apparently the practice was to announce all 2-1 decisions as unanimous, and to not permit any dissent to be public. To some, this represents an effort to reduce uncertainty; to others, it may represent a procedure designed to

of special commercial courts to handle revised bankruptcy procedures did not increase confidence through the use of specialization; instead, it only served to increase distrust of the system, based in part on the generalized notion that cases could be "bought" for as little as US$20,000.[32]

Of course, the integrity of the domestic legal system may not be a major factor in a state's decision to adopt the Convention. It is, however, sufficient reason to temper expectations and to work for system-wide reforms that will allow the Convention, as well as necessary reforms to domestic legal systems, to succeed.

IV. CONCLUSION

Mr. Bazinas' article will no doubt be cited often and with good result for lawyers and legislators trying to work through the Convention. In addition to his guidance on interpretation, he has also rightly pointed out that the Convention will facilitate securitization, with its attendant economic benefits, especially in emerging economies. The Convention, like a great Shakespearean drama, will not reveal its worth, if the players who realize it, giving voice to its text and provisions are unskilled, or if the theater in which it will be produced is unsuitable. So long as work continues to improve the administration of civil justice, and so long as judges are faithful to the Convention's finely-crafted text, the Convention could truly make a difference in the global economy.

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stunt the growth of the law. *IBRA Insists Ad Hoc Judges Be Used in Bankruptcy Cases*, THE JAKARTA POST, Apr. 12, 2000, at 9.

32. *See IBRA Critisizes Jakarta Commercial Court*, THE JAKARTA POST, May 19, 2000, at 8.