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RECEIVABLES FINANCING

Commentary to the draft Convention on Assignment in Receivables Financing (Part II)

Note by the Secretariat

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INTRODUCTION

This document contains the second part of the commentary to the draft Convention on Assignment in Receivables Financing (the title of the draft Convention has not been adopted yet by the Working Group; see A/CN.9/WG.II/WP.104, remarks to the title and the preamble). The second part of the commentary begins where the first part ended, i.e. with draft article 13, and goes up to draft article 31 (the first part of the commentary is contained in document A/CN.9/WG.II/WP.105). The commentary on the final provisions and the annex, if retained (see A/CN.9/WG.II/WP.104, remarks to the annex), will be prepared after the adoption of the draft Convention as a whole by the Working Group.

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

COMMENTARY

1. Unlike the other provisions of the draft Convention which deal with assignment as a transfer of property rights in receivables, the provisions contained in this section deal with issues that are normally addressed in the contract of assignment or other agreement between the assignor and the assignee. The usefulness of these provisions lies in the fact that they recognize party autonomy and allocate risks in the absence of an agreement between the assignor and the assignee.

* * *

Article 13. Rights and obligations of the assignor and the assignee

REFERENCES

A/CN.9/432, paras. 131-144
A/CN.9/434, paras. 148-151
A/CN.9/447, paras. 17-24
A/CN.9/456, paras. 127-128

COMMENTARY

2. The primary purpose of draft article 13 is to restate in the context of the relationship between the assignor and the assignee the principle of party autonomy, a principle already enshrined in general terms in draft article 6. The assignor and the assignee are free to structure their mutual rights and obligations so as to meet their particular needs. They are also free to incorporate into their agreement any rules or conditions by referring to them in a general manner, rather than reproducing them in their agreement. The conditions under which the parties may exercise their freedom and the relevant legal consequences are left to the law governing their agreement.

3. Inspired by article 9 of the United Nations Convention on Contracts for the International Sales of Goods (hereinafter referred to as “the United Nations Sales Convention”), draft article 13 also states in paragraphs (2) and (3) a principle that may not be recognized in all legal systems, namely that, in the interpretation of assignment contracts, trade usages and practices must be taken into account. Paragraph (2) draws a clear distinction between trade usages and practices to the extent that the former need to be agreed upon so as to bind the parties, while the latter are binding without a specific agreement unless parties agree not to be bound. Such usages and practices produce rights and obligations for the assignor and the assignee. They cannot bind, however, third parties, such as the debtor or creditors of the assignor. They cannot bind subsequent assignors or assignees either. All those parties would not be necessarily aware of usages and practices agreed upon by the initial assignor and the initial assignee.

4. In view of the fact that paragraph (1) recognizes party autonomy, parties would always have the right to agree otherwise as to the binding nature of practices established between themselves. The words “unless otherwise agreed”, contained in paragraph (2), may, therefore, not be necessary. These words, which do not appear in article 9 (1) of the United Nations Sales Convention, had been initially included in paragraph (2), since, as opposed to the hierarchy of legal rules established in the United Nations Sales Convention, the draft Convention prevails over the parties’ agreement. After the limitation of paragraph (1) to the mutual rights and obligations of the assignor and the assignee, the rule about the prevalence of the draft Convention has been deleted and the reason for deviating from the wording of article 9 (1) of the United Nations Sales Convention has been eliminated.

5. Paragraph (3) defines the scope of the matters covered by an international usage. Under paragraph (3), international usages bind only the parties to international assignments. Such a limitation was not thought to be necessary in article 9 since the United Nations Sales Convention applies only to international sales. It was thought, however, to be necessary in draft article 13 in view of the fact that the draft Convention may apply to domestic assignments of international receivables. In addition, under paragraph (3), as under article 9 (2) of the United Nations Sales Convention, usages are applicable only to the relevant practice. This means that an international factoring usage cannot apply to an assignment in a securitization transaction. However, unlike draft article 9 (2) of the United Nations Sales Convention, paragraph (3) does not refer to the subjective, actual or constructive, knowledge of the parties but only to the objective requirements that the usages must be widely known and regularly observed. The Working Group felt that, while such a reference to the subjective knowledge of the parties might be useful in a two-party relationship, it would be inappropriate in a tripartite relationship, since it would be extremely difficult for third parties to determine what the assignor and the assignee knew or ought to have known.

* * *

Article 14. Representations of the assignor

REFERENCES

A/CN.9/420, paras. 80-88

A/CN.9/432, paras. 145-158

A/CN.9/434, paras. 152-161

A/CN.9/447, paras. 25-40

A/CN.9/456, paras. 129-130

COMMENTARY

6. Representations undertaken by the assignor are intended to reduce the risk involved in a transaction as to whether the assignee will be able to collect the receivables from the debtor, if necessary (in an assignment by way of security, the assignee does not need to collect unless the assignor defaults and in securitization or undisclosed invoice discounting the assignor continues to collect from the debtor as an agent of the assignee). As a result, representations constitute a significant factor for the assignee to determine the amount of credit to be made available to the assignor and the cost of credit.

7. In view of their importance for the pricing of a transaction, representations are highly negotiated and explicitly settled between the assignor and the assignee. Recognizing this reality, draft article 14 enshrines the principle of party autonomy with regard to representations of the assignor. Such representations may stem from the financing contract, the contract of assignment (if it is a separate contract), or from any other contract between the assignor and the assignee. In accordance with draft article 13 (2) and (3), they may also stem from trade usages and practices.

8. In addition to recognizing the principle of party autonomy, draft article 14 is intended to set forth a default rule allocating risks between the assignor and the assignee in the absence of an agreement of the parties as to this matter. In the allocation of risks, the overall aim of draft article 14 is to counterbalance the need for fairness and the need to facilitate increased access to lower-cost credit. Fairness is served to the extent that draft article 14 reflects a balance often established by the agreement of the parties. Normally, in financing agreements the assignor guarantees the existence of the assigned receivable but not the solvency of the assignor. On the other hand, increased access to lower-cost credit is served in so far as, if the parties have not agreed on representations, in the absence of a rule along the lines of draft article 14, the risk of non-payment would be higher. This situation could defeat a transaction (if the risk is too high) or, at least, reduce the amount of credit offered and raise the cost of credit. To the extent that the assignor is able to pass the cost to the debtor, the assignor's goods or services would be more expensive or even inaccessible to the debtor.

9. Under paragraph (1), the assignor represents that it has the right to assign the receivable, it has not assigned it already and that the debtor does and will not have any defences. In view of the need for the assignee to be able to estimate the risk involved in a transaction before extending credit, paragraph (1) provides that the representations have to be made, and take effect, at the time of the conclusion of the contract of assignment. Such representations are considered as being given not only to the immediate assignee but also to any subsequent assignee. As a result, any subsequent assignee may turn against the assignor for breach of representations. If representations were considered as being undertaken only as against the immediate assignee, any subsequent assignee would have recourse only against its immediate assignor, a process that would increase the risk and thus the cost of transactions involving subsequent assignments.

10. Subparagraphs (a) to (c) introduce representations that could be broadly described as representations relating to "the existence" of the receivable (or its assignability). If the assignor does not have the power to assign, has already assigned, or has deprived the receivables of any value by improperly performing the contract with the debtor, the receivable does not "exist". In this regard, during the deliberations of the Working Group, the concern was expressed that, by allowing the parties to modify representations relating to the very existence of the assigned receivables, draft article 14 might run counter to good faith standards. In order to address that concern, the suggestion was made that draft article 14 should be deleted altogether, or should not be subject to party autonomy or, at least, should be made subject to modification only by way of an explicit agreement of the parties. However, the Working Group agreed to retain draft article 14 unchanged. It was widely felt that, while making business practice conform to good faith standards is an important goal, this should not be at the expense of the parties' ability to agree on risk-and thus cost-allocation in financing transactions. As a result, it was agreed that party autonomy should not be restricted, while contract interpretation in the case of an implicit agreement should be left to the law governing the contract.

11. The assignor is in violation of the representation as to its right to assign, introduced in subparagraph (a), if the assignor does not have the capacity or the authority to act, or if there is any statutory limitation on assignment. This approach is justified by the fact that the assignor is in a better position to know whether the assignor has the right to assign. However, the assignor is not liable for breach of representations if the original contract contains an anti-assignment clause. The Working Group decided that no explicit reference to that rule was necessary in subparagraph (a), since it is implicit in draft article 10, under which the assignment is effective even if it is in breach of an anti-assignment clause.

12. The representation, contained in subparagraph (b), that the assignor has not already assigned the receivable is aimed at holding the assignor accountable to the assignee if, as a result of a previous assignment by the assignor, the assignee does not have priority. This result may occur if the assignee has no objective way to determine whether a previous assignment has occurred. Subparagraph (b), however, does not require the assignor to represent that it will not assign the receivables to another assignee after the first assignment. Such a representation would run counter to modern financing practice in which the right of the assignor to offer to different lenders parts of the same receivables as security for obtaining credit is absolutely essential. Such negative-pledge type of representation is normally part of certain exceptional transactions, such as subordination agreements by way of which claimants of the same receivables settle conflicts of priority.

13. Subparagraph (c) places on the assignor the risk of hidden defences or rights of set-off of the debtor that may defeat in whole or in part the assignee's claim. This provision is premised on the fact that, by performing its contract with the debtor properly, the assignor will be able to preclude such defences from arising. In particular in the context of the sale of goods in which service and maintenance elements are included, such an approach would result in a greater degree of accountability of the assignor for performing properly its contract with the debtor. The provision is also based on the assumption that, in any case, the assignor will be in a better position to know whether the contract will be properly performed, even if the assignor is just the seller of goods manufactured by a third person. In all those cases, there is no need that the assignor has actual knowledge of any defences.

14. Subparagraph (c) has a wide scope, encompassing defences and rights of set-off whether they have a contractual or non-contractual source and whether they relate to existing or to future receivables. It also covers rights of set-off arising from contracts unrelated to the original contract. With regard to representations relating to the absence of defences against future receivables assigned in bulk by way of security, the Working Group thought that the representation contained in subparagraph (c) properly reflects current practice. According to such practice, in bulk assignments of defence-free and defence-ridden receivables assignors normally receive credit only in the amount of those receivables that are not likely to be subject to defences, while they have to repay a higher amount. In addition, in the case of non-payment by the debtor, the assignor has to take back the receivables for which the assignee is not able to obtain payment from the debtor and replace them with other receivables or to pay back the price of the unpaid receivables ("recourse financing").

15. The legal consequences of a breach of representations by the assignor are left to law applicable outside the draft Convention. The Working Group considered, in particular, the question whether, in the case of breach of representations by the assignor, the receivables are automatically retransferred to the assignor or whether, in such a case, an act of retransfer is necessary. The practical importance of

this question lies in the fact that, if the receivables that the assignee is not able to collect are automatically retransferred and the assignor has in the meantime become insolvent, the assignee may have a better chance of separating the price paid for the receivables from the insolvency estate or, at least, of being paid from the proceeds of the receivables before unsecured creditors. If, on the other hand, an act of transfer is needed and the assignor has become insolvent, the retransfer will not be accepted by the insolvency administrator. The Working Group decided not to deal with the legal consequences of a breach of representations, holding that this matter involves a breach of the financing contract or the contract of assignment (if it is a different contract) and should be left to the law governing that contract. Reasons cited by the Working Group in support of this approach include that: matters relating to the underlying financing contract are beyond the scope of the draft Convention; and, in any case, it would be very difficult for the Working Group to reach agreement on issues such as liability for breach of representations.

16. Paragraph (2) reflects the generally accepted principle that the assignor does not guarantee the solvency of the debtor. As a result, the risk of debtor-default is on the assignee, a fact that the assignee takes into account in determining whether to extend credit and on what conditions. Recognizing the right of the parties to financing transactions to agree on a different risk-allocation, with a view to pricing the transaction in a different way, paragraph (2) allows the assignor and the assignee to agree otherwise. Paragraph (2) also provides that such an agreement may be implicit or explicit. The question of what constitutes an implicit agreement is left to the contract interpretation rules of the law governing the contract.

* * *

Article 15. Right to notify the debtor

REFERENCES

A/CN.9/420, paras. 89-94 and 119-122

A/CN.9/432, paras. 159-164 and 175

A/CN.9/434, paras. 162-165

A/CN.9/447, paras. 41-47

A/CN.9/456, paras. 131-144 and 193

COMMENTARY

17. Draft article 15 deals with the question of who as between the assignor and the assignee has the right to notify the debtor and to request payment. It is not intended to address the conditions for a notification to be effective as against the debtor, which is dealt with in draft article 18, or the question of whom the debtor has to pay in order to obtain a valid discharge, which is dealt with in draft article 19, or other legal consequences of notification, dealt with in draft articles 20 and 22 (as to those matters, see para. 33)

18. The main objective of draft article 15 is to recognize the right of the assignee to notify the debtor and to request payment, without the cooperation or the authorization of the assignor. The Working Group recognized that, in some practices, it is normal for the assignor to notify the debtor at the time an

assignment is made and to request that payment be made to the assignee (e.g., in factoring). At the same time, however, the Working Group was mindful of the fact that, in other practices, it was important for the assignee to be able to notify independently of the assignor, whether in the event of default or not. It was widely felt that, as a matter of principle, the assignee as the new creditor should have, as against the assignor, the right to notify the debtor and to request payment. The protection of the debtor against the risk of being notified and being asked to pay a potentially unknown person was thought to be a different matter which could be addressed by allowing the debtor in the case of notification by the assignee to request adequate proof (see paras. 47)

19. Granting the assignee an autonomous right to notify the debtor was considered to be practically important, in particular since the assignor might be unwilling or, in the case of insolvency, unable to cooperate with the assignee. Furthermore, it was thought that, at least in those legal systems in which priority was determined on the basis of the time of notification of the debtor, the assignor, acting in collusion with one claimant against the interests of another claimant, could determine the order of priority, unless each claimant had the right to notify the debtor independently of the assignor. The Working Group confirmed that the assignor may always notify the debtor independently of any assignee, even if such notification would constitute a breach of an agreement between the assignor and the assignee. It was widely felt that the debtor should be able to discharge its obligation as directed by the assignor in the notification and should not concern itself with the private arrangements existing between the assignor and the assignee (however, after notification of the assignment, the debtor is discharged by paying the assignee or as instructed by the assignee; see change to draft article 19 (2) suggested by the Secretariat in A/CN.9/WG.II/WP.104, remark 8 to draft article 19).

20. With a view to accommodating non-notification practices, notification is formulated in paragraph (1) as a right and not as an obligation. In such practices, normally the debtor is not notified of the assignment and the assignor receives payment on behalf of the assignee. Draft article 15 is also intended to recognize practices in which the debtor keeps paying as before the assignment, while the assignor and the assignee agree on the control of the account or address (e.g., a post office box) to which payment is made. In those practices, in order to avoid any inconvenience to the debtor that might result in an interruption to the normal flow of payments, the debtor is either not notified at all or is notified and instructed to continue paying the assignor (such a notification is normally intended to preclude the debtor from acquiring rights of set-off after notification from contracts unrelated to the original contract). Only in exceptional situations (e.g., in the case of default), the debtor is notified and given different payment instructions (i.e. to pay the assignee or another person or to a different account or address).

21. While draft article 15 grants the assignee an autonomous right to notify the debtor and to request payment, it also recognizes the right of the assignor and the assignee to negotiate and agree on the matter of notification of the debtor so as to meet their particular needs. For example, the assignor and the assignee may agree that no notification would be given to the debtor as long as the flow of payments is not interrupted (as, e.g., in undisclosed invoice discounting). In order to ensure that there is no need for a specific agreement, the opening words of paragraph (1) are formulated in a negative way (“unless otherwise agreed”).

22. The definition of “notification” contained in draft article 5 does not include any reference to the identification of the payee and draft article 15 makes separate reference to notification and request of

payment. This approach is intended to recognize the difference, both in purpose and in time, between a notification and a payment instruction and to validate practices in which notification is given without any payment instructions. Under this approach, a mere notification of an assignment is valid for the purpose of cutting off the debtor's rights of set-off arising from contracts unrelated to the original contract, as well as for the purpose of changing the way in which the assignor and the debtor may amend the original contract. However, in order to avoid complicating the debtor's discharge, the Working Group decided not to define "payment instruction" nor to base the debtor's discharge on the receipt of a payment instruction. Under paragraph (1), a payment instruction may be sent either by the assignor with the notification or, subsequent to a notification, by the assignee. Paragraph (1), unlike draft article 19, refers to the time notification is "sent" (and not "received"), since neither the assignor nor the assignee has a way to assess the time of receipt. That matter may be important for the discharge of the debtor, dealt with in draft article 19, but not for the determination of who as between the assignor and the assignee has the right to give a payment instruction.

23. Paragraph (2) deals with the effectiveness of a notification given in breach of an agreement between the assignor and the assignee. The rule, introduced in the first sentence of paragraph (2), is that, if notification is given in violation of such an agreement and the debtor pays, the debtor is discharged (as this is a matter of the debtor's discharge, the Working Group may wish to consider moving the first sentence of paragraph (2) to draft article 19; see A/CN.9/WG.II/WP.104, remarks to draft article 15). Whether the person violating such an agreement is liable for breach of contract, under law applicable outside the draft Convention, is a separate matter and should not affect the discharge of the debtor, who is not a party to that agreement. A notification given in violation of an agreement between the assignor and the assignee, however, does not: cut off any rights of set-off of the debtor from contracts unrelated to the original contract (draft article 20); trigger a change in the way the assignor and the debtor may amend the original contract (draft article 22); or create a basis for the determination of priority under the law applicable to priority issues (draft articles 24-26). The Working Group thought that such results would give an undue advantage to the assignee who wrongfully notified the debtor. The negative formulation in paragraph (2) "is not ineffective" is intended to ensure that the mere violation of an agreement between the assignor and the assignee, on the one hand, does not invalidate the notification for the purpose of debtor-discharge, but, on the other hand, does not interfere with contract law as to the conditions required for such an agreement to be effective.

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Article 16. Right to payment

REFERENCES

A/CN.9/447, paras. 48-68

A/CN.9/456, paras. 145-159

COMMENTARY

24. Draft articles 2, 8 and 15 establish, as between the assignor and the assignee, the assignee's right to request payment. It is, therefore, subject to the general principle of party autonomy embodied in draft article 6 and is formulated as a default rule applicable in the absence of an agreement between the

assignor and the assignee. It is also subject to the debtor-protection and the priority provisions of the draft Convention. While draft article 16 does not define proceeds, it is formulated in a broad way so as to encompass both proceeds of receivables and proceeds of proceeds, as well as payment both in cash and in kind, e.g., returned goods (for a suggestion to define “proceeds” and to refer to “payment or other discharge”, see A/CN.9/WG.II/WP.104, remark 1 to draft article 16).

25. The assignee’s right in proceeds is independent of any notification of the assignment. The reason for this approach is the need to ensure that: if payment is made to the assignee before notification, the assignee may retain the proceeds of payment; and if payment is made to the assignor after notification (which does not discharge the debtor’s debt), the assignee would have a right in such payments. Such a right is of particular importance, if the assignor or the debtor becomes insolvent. If payment is made to the assignor after notification, in principle, the assignee could claim payment from the assignor, under draft article 16 (1) (b), or from the debtor, under draft article 19 (2). In practice, however, the assignee would not claim a second payment from the debtor, unless the assignor has become insolvent. In such a case, any claim that the debtor might have against the estate of the insolvent assignor (e.g., on the basis of the principles of unjust enrichment) would normally be meaningless, since it is unlikely that claimants with personal claims would be able to obtain payment. However, this result is appropriate in that the debtor, who pays the assignor after notification, takes the risk of having to pay twice.

26. Draft article 16 covers the situations in which payment has been made to the assignee, the assignor or another person. In the latter case, the assignee’s right is subject to priority. In this context, the Working Group decided not to make a broad reference to any “superior right under applicable law” which would encompass the right of a depositary institution in payments received in good faith. The Working Group thought that the assignee should not be able to claim from the depositary institution such payments received in good faith and commingled with other assets (for a suggestion to clarify in paragraph (2) that the right to claim payment from a third person is a right as between the assignor and the assignee which is subject to party autonomy, see A/CN.9/WG.II/WP.104, remark 2 to draft article 16).

27. Under paragraph (2), while the assignee may claim all the proceeds of payment, it may only retain an amount equal to the amount owed plus any interest (the assignor’s right to interest may need to be addressed explicitly; see A/CN.9/WG.II/WP.104, remark 3 to draft article 16). This approach is intended to reflect normal practice in assignments by way of security, under which the assignee may have the right to collect the full amount of the receivable but has to account for and return to the assignor or its creditors any balance remaining after payment of the assignee’s claim. The Working Group may wish to reconsider whether the expression “value of its right” adequately reflects the intent of paragraph (2).

28. As to the interplay between draft articles 12 and 16, it should be noted that the sovereign debtor could discharge its debt by paying the assignor, while the assignee would have a right to claim the proceeds of payment from the assignor. The question whether that right is a right *in rem* or *ad personam* is left to the law applicable to priority.

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Article 17. Principle of debtor protection

REFERENCES

A/CN.9/420, para. 101

A/CN.9/432, paras. 33-38, 89-90, 206 and 244

A/CN.9/434, paras. 86-95

A/CN.9/445, paras. 195-198

A/CN.9/456, paras. 21, 81 and 168-176

COMMENTARY

29. The primary goal of any assignment-related law may be to strike an appropriate balance between, on the one hand, the need to allow parties to mobilize their receivables for the purpose of obtaining credit and services and, on the other hand, to ensure that the legal position of the debtor is not adversely affected. In order to highlight the importance of the need to protect the debtor in a prominent manner, the Working Group decided to include a reference in the preamble and a general statement of this principle of paramount importance for the draft Convention in draft article 17. The debtor-protection principle finds more specific application in the provisions of section II of chapter IV. It is also the reason for the requirement contained in draft article 1 (3) that, for the provisions of the draft Convention that affect the debtor's rights and obligations to apply (i.e. chapter III and section II of chapter IV), the debtor needs to be in a Contracting State. The same principle is the reason for the limitation of the right of the assignor and the assignee to opt out of the draft Convention as a whole (draft article 6). Such an opting out could set aside the debtor-protection system introduced by the draft Convention. The need to introduce a special protection for sovereign debtors is also the underlying policy in draft article 12. Draft article 28, subjecting a number of debtor-related issues to the law governing the receivable is also a special application of the general principle enshrined in draft article 17. This law will be the law governing the original contract, which is likely to be the law chosen by the assignor and the debtor at the time they undertook their original obligations.

30. The basic rule of paragraph (1) is that the draft Convention is not intended to adversely affect the debtor's rights and obligations. The draft Convention is, in particular, not designed to change the payment terms stipulated in the original contract (e.g., the amount owed, the time and the place of payment). There are three exceptions to this basic rule. First, the debtor may negotiate with the assignor or the assignee and agree to waive its defences or rights of set-off. Such an agreement may allow the debtor to obtain a benefit, such as a higher amount of credit, a longer repayment period or a lower interest rate. Draft article 21 deals with such an agreement between the assignor and the debtor and introduces certain limitations. It does not deal, however, with waivers of defences agreed upon by the assignee and the debtor, which are left to other law. Whether a waiver of defences is to be construed as a consent or confirmation of the debtor's consent to the assignment is also left to other law (see para. 56).

31. The second exception lies in those provisions of the draft Convention that do affect the debtor's legal position. Those provisions include: draft article 10 (an assignment is effective even if it is made despite the existence of an anti-assignment clause); draft article 19 (after notification, the debtor may discharge its obligation by paying as instructed in the notification or in a subsequent payment instruction

given by the assignee); draft article 20 (2) (after notification, the debtor may not raise against the assignee any right of set-off arising from contracts unrelated to the original contract); draft article 20 (3) (the debtor may not raise against the assignee any claim for breach of an anti-assignment clause by the assignor); draft article 22 (after notification, the debtor's right to modify the original contract without the consent of the assignee is limited); and draft article 23 (the debtor cannot recover from the assignee any payments despite the fact that the assignor may have failed to perform; the debtor will have to recover such payments from the assignor and thus bear the risk of insolvency of its contractual partner).

32. The third exception to the rule established in paragraph (1) is contained in paragraph (2). Under paragraph (2), a payment instruction, whether given with the notification or subsequently, may change the person, address or account to which payment is to be made. However, a payment instruction may not change the currency of payment. It may not change the country of payment either, unless the change is beneficial to the debtor and results in payment being allowed in the country in which the debtor is located. Such a change of the country of payment is often allowed in factoring contracts with a view to facilitating payment by debtors.

* * *

Article 18. Notification of the debtor

REFERENCES

A/CN.9/420, paras. 124-125

A/CN.9/432, paras. 176-177, 187

A/CN.9/434, paras. 172-175

A/CN.9/447, paras. 45-47 and 158-159

A/CN.9/455, paras. 59-66

A/CN.9/456, paras. 177-180

COMMENTARY

33. As already mentioned (para. 17), the draft Convention deals with the various aspects of notification of assignment in several articles. Draft article 5 (f) defines notification for the purposes of the draft Convention. Draft article 15 deals with notification as a right of the assignor and the assignee. Draft article 18 addresses notification issues that are relevant to the legal position of the debtor in general. It also refers to a payment instruction, which, while not defined in the draft Convention, is generally described in draft article 17 (2). Draft articles 19, 20 and 22 deal with the legal consequences of notification.

34. The primary purpose of draft article 18 is to restate the "receipt rule", i.e. that a notification and a payment instruction become effective when received by the debtor. The main reason for the adoption of this rule by the Working Group is that a notification, whether accompanied by a payment instruction or not, has significant consequences for the legal position of the debtor (it triggers a change in the way in which the debtor may discharge its debt, it cuts off rights of set-off arising from contracts unrelated to the original contract and it changes the way in which the debtor may amend the original contract in agreement with the assignor). Such consequences may occur only when a notification or a payment

instruction is in a language that is “reasonably expected to inform the debtor about its contents”. For example, when the notification is in electronic form and is not readily readable, the debtor should be able to decode it easily. In order to avoid creating uncertainty, paragraph (1) introduces a “safe harbour” rule, according to which the language of the original contract meets the required standard.

35. Upon receipt of a notification, if the debtor is not prepared to accept any change that may result from an assignment, the debtor, knowing that it will not be able to accrue additional rights of set-off, may avoid to enter into further contractual relationships with the assignor. In exceptional cases, in which the assignment is a fundamental breach of an anti-assignment agreement, the debtor may even be able to avoid the original contract. However, such a radical remedy should be exercised only when an assignment results in extreme hardship to the debtor. Otherwise, the risk of the contract being avoided might in itself have a negative impact on the cost and the availability of credit (see para. 50; see also A/CN.9/WG.II/WP.105, para. 86). In order to avoid this result, the Working Group may wish to consider clarifying in draft article 10 that any relief available to the debtor against the assignor for breach of an anti-assignment clause would be limited to a claim for compensatory damages (or that the debtor may not declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause). This result could be obtained anyway, since draft articles 10, 20 (3) and 22 could be construed as precluding such a radical remedy, at least after notification of the assignment. Allowing the debtor to declare the contract avoided on the sole ground of the violation of an anti-assignment clause would run counter to the principle that the assignment is effective even if it is made in violation of an anti-assignment clause and to the principle that, in such a case, the debtor may not raise against the assignee any claim it might have against the assignor for breach of contract. In addition, if the minimum, i.e. a modification of the original contract, is not allowed after notification of the debtor without the consent of the assignee, the maximum, i.e. the cancellation of the contract, could not be allowed either.

36. Under paragraph (2), a notification may relate to future receivables. This rule is of paramount importance. If a notification or a payment instruction relating to future receivables could not be effectively given, the debtor could refuse to pay the assignee despite a notification or a payment instruction. Furthermore, if the law applicable to priority issues under draft articles 24 to 26 settles priority conflicts on the basis of the time of notification, assignees would not be able to effectively notify the debtor and thus to establish priority as to future receivables (see para. 78). Such a result could virtually defeat the availability of credit on the basis of future receivables.

37. The Working Group considered the question whether, in order to protect the assignor against the risk of being deprived of all its receivables, the effectiveness of a notification relating to future receivables should be limited to a fixed period of time, which could possibly be extended by way of a second notification. The Working Group decided not to introduce such a limitation. It was thought that such restrictions were a matter for the financing contract, with which the draft Convention should avoid any interference. It was also considered that any fixed time period would be arbitrary and disruptive of commercial practices based on long-term relationships. In particular in long-term contracts, a requirement for the renewal of a notification at the expiry of a fixed period could be overly burdensome both for the assignee and the debtor. The assignee would find it difficult to establish the date of receipt of the notification by the debtor, when the fixed time period would start running. The debtor would be overly burdened with the obligation to verify the date in the past when notification had been received in order to assess whether it could obtain a discharge by paying the assignee.

38. Paragraph (3) is one of the most important provisions of the draft Convention, in particular for international factoring transactions. In such transactions, the assignor normally assigns the receivables to an assignee in its own country (export factor) and the export factor subsequently assigns the receivables to an assignee in the debtor's country (import factor). Under such an arrangement, collection from the debtor is facilitated to the extent that the import factor is able to take all the necessary measures for the second assignment to be effective as against the debtor. The efficient operation of such transactions is based on the assumption that the first assignment is also effective as against the debtor. In view of the fact that the debtor is normally notified only of the second assignment, it is essential to ensure that that notification of the second assignment covers the first assignment as well. Otherwise, the first assignment might be rendered ineffective as against the debtor, a situation which might affect the effectiveness of the second assignment as well. In order to address situations in which more than one subsequent assignment is made, paragraph (3) provides that a notification covers any prior, and not only the immediately preceding, assignment (as to the issue of discharge of the debtor in the case of several notifications relating to subsequent assignments, see para. 45).

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Article 19. Debtor's discharge by payment

REFERENCES

A/CN.9/420, paras. 98-117, 127-131, 169-173 and 179

A/CN.9/432, paras. 165-174 and 178-204

A/CN.9/434, paras. 176-191

A/CN.9/447, paras. 69-93 and 153-157

A/CN.9/455, paras. 52-58

A/CN.9/456, paras. 181-193

COMMENTARY

39. Draft article 19 has a twin goal, to provide a clear mechanism for the discharge of the debtor's obligation by payment and to ensure payment of the debt. It is not intended to deal with the discharge of the debtor in general or with the payment obligation as such, since that obligation is subject to the original contract and to the law governing that contract. The basic rule is that, until the debtor receives notification of an assignment, it may be discharged by paying in accordance with the original contract, while, after notification, discharge is obtained only by payment in accordance with the instructions given by the assignor or by the assignee with the notification, or subsequently by the assignee. Draft article 19 deals also with a number of particular situations in which: several notifications are involved; the debtor is notified by the assignee and is in doubt as to whether the assignee is the rightful claimant; discharge by payment under law applicable outside the draft Convention; and discharge by payment in the case of an assignment that is null and void.

40. Under paragraph (1), until the time of receipt of a notification, the debtor is entitled, not obliged, to discharge by paying in accordance with the original contract (i.e. by paying the assignor or another person or to an account or address indicated in the original contract). In view of the fact that the

assignment is effective as of the time of the conclusion of the contract of assignment, the debtor, having knowledge of the assignment, may choose to discharge its debt by paying the assignee. However, in such a case the debtor takes the risk of having to pay twice, if it is later proven that no assignment took place. The Working Group decided not to refer explicitly to the possibility of the debtor being able to pay either the assignor or the assignee in order to avoid undermining practices, such as securitization, in which the debtor is normally expected to continue paying the assignor (however, the problem may not be resolved in this way; for the Secretariat's suggestion in this regard, see A/CN.9/WG.II/WP.104, remark 1 to draft article 19). The reference to payment "in accordance with the original contract", rather than to payment to the assignor, is intended to preserve the right of the assignor and the debtor to agree to any type of payment suitable to meet their needs (e.g., payment to a bank account without identification of the account owner, or payment to a third person).

41. The Working Group considered at some length the question whether knowledge of an assignment should be treated as a notification and trigger a change in the way in which the debtor could discharge its obligation. It was argued that it would run counter to good faith to allow the debtor to discharge its debt by paying the assignor, in particular if the debtor had actual knowledge of the assignment, or by paying the assignee, in particular if the debtor knew that someone else had a superior right. The Working Group decided that knowledge of an assignment should not affect the discharge of the debtor. It was widely felt that, while making business practice conform to good faith standards is an important goal, this should not be at the expense of certainty. Certainty would be reduced if knowledge of the assignment were to trigger a change in the way in which the debtor could discharge its obligation. In such a case, the assignor or the person with a superior right, who would not be in control of the relevant evidence, would need to establish what the debtor knew. If the burden of proof were to be placed on the debtor, the debtor would not be able to obtain a valid discharge unless it was able to establish that it had no knowledge of the assignment. In such a case, it would need to be determined what constitutes knowledge (e.g., general knowledge of the fact that an assignment took place or knowledge of the details of the assignment, such as the exact amount of the receivables assigned and, in the case of an assignment by way of security, of the debt secured). This process would be particularly cumbersome in the case of several conflicting assignments. As a result, the certainty necessary in a debtor-discharge rule would be seriously compromised. The Working Group also took into account that in certain cases (e.g., in securitization and undisclosed invoice discounting) it is normal business practice for the debtor to continue paying the assignor even though the debtor knows of the assignment, since the assignee does not have the business structure necessary to receive payments.

42. The Working Group also considered the question whether the nullity (e.g., for fraud or duress or lack of capacity to act) or the knowledge of the nullity of an assignment should be taken into account in the debtor's discharge. At an early stage in its work, the Working Group considered a provision, according to which the debtor should be able to discharge its obligation even if any of the assignments in a chain of assignments was null and void (A/CN.9/WG.II/WP.96, draft article 27). It was thought that the debtor should not be exposed to the risk of having to pay twice merely because parties unknown to the debtor chose to engage in subsequent assignments. Ultimately, the Working Group decided that the issue of payment to a person the assignment to whom was null and void arose only in exceptional situations and could be left to law applicable outside the draft Convention (this is the thrust of draft article 19 (8); for the Secretariat suggestions with regard to this matter, see A/CN.9/WG.II/WP.104, remarks 6-8 to draft article 19).

43. Unlike paragraph (1), paragraph (2) does not allow the debtor a choice as to how to discharge its debt. After notification, the debtor can only discharge its obligation by paying the assignee or as instructed by the assignee. The reference to payment instructions is intended to address the needs of various practices. The assignee may, for example, notify the debtor, so as to freeze the debtor's rights of set-off, without requesting payment or requesting the debtor to continue paying the assignor (this is the case, e.g., with undisclosed invoice discounting or securitization). The Working Group may wish to explicitly state in paragraph (2) what is already stated in draft article 15 (1), namely that such instructions may be given by the assignor or the assignee with the notification or only by the assignee subsequent to a notification (see A/CN.9/WG.II/WP.104, remark 8 to draft article 19).

44. Paragraphs (3) and (5) are intended to provide simple and clear discharge rules in the case of several notifications. Paragraph (3) deals with situations in which the debtor receives several notifications relating to more than one assignment of the same receivables by the same assignor ("duplicate assignments"). Such situations do not necessarily involve fraud. They may, for example, involve several assignments of different parts of the receivables by way of security, in which the main issue is who will obtain payment first (i.e. who has priority). Having agreed that the assignment should not adversely affect the legal position of the debtor, the Working Group drew a clear distinction between the issue of the debtor's discharge and the issue of priority. Thus, payment under paragraph (3) in accordance with the first notification discharges the debtor, even if the person receiving payment does not have priority. The underlying rationale is that it would be unfair and inconsistent with the policy of debtor protection to require the debtor to determine who among several claimants has priority and that the debtor pays a second time if it pays the wrong person. The debtor would most likely have a cause of action against that person, but the debtor's rights may be frustrated if that person becomes insolvent. The risk of insolvency of the debtor receiving payment should be on the various claimants of the receivables and not on the debtor. Such claimants would have to settle among themselves their rights in the proceeds of payment in accordance with the law governing priority under the draft Convention.

45. Paragraph (5) deals with notifications relating to more than one subsequent assignment. Such situations are rare in practice, since normally only the last in a chain of assignees notifies the debtor and requests payment. In any case, in order to avoid any uncertainty as to how the debtor may discharge its debt, paragraph (5) provides that the debtor has to follow the instructions contained in the notification of the last assignment in a chain of assignments. For that rule to apply, the notifications received by the debtor have to be readily identifiable as notifications relating to subsequent assignments. Otherwise, the rule contained in paragraph (3) would apply and the debtor would be discharged by payment in accordance with the first notification received. In any case, under paragraph (6), the debtor, if in doubt, could request adequate proof from the assignees notifying (for a Secretariat suggestion that, until such proof is offered, the debtor could discharge its debt by paying the assignor, see A/CN.9/WG.II/WP.104, remark 2 to draft article 19). If the debtor receives several notifications relating to several assignments of the same receivables by the same assignor and to subsequent assignments, under a combined application of paragraphs (3) and (5), the debtor is discharged by paying in accordance with the first notification of the last assignment.

46. Paragraph (4) is intended to ensure that the assignee may change or correct its payment instructions. Whether the debtor is notified by the assignor or the assignee, if a new payment instruction is sent with regard to one and the same assignment, the debtor may discharge its debt only in accordance with that instruction. The only condition is that, in line with the policy underlying draft

article 15 (1), that payment instruction, which is given subsequent to the notification, has to be given by the assignee, who is the only person entitled to dispose of the receivables. In order to protect the debtor against the risk of having to pay twice, paragraph (4) expressly provides that a payment instruction received by the debtor after payment is to be disregarded.

47. Under draft article 15, notification may be given by the assignor or by the assignee independently of the assignor. As a result, the debtor receiving notification of the assignment from a possibly unknown person may be in doubt as to whether that person is a legitimate claimant, payment to whom would discharge the debtor. In order to protect the debtor from uncertainty as to how to discharge its debt in such cases, paragraph (6) gives the debtor a right to request the assignee to provide adequate proof of the assignment within a reasonable period of time. Paragraph (6) does not introduce an obligation of the debtor, since requesting additional proof in all cases would unnecessarily delay payment and add to the cost of the notification. The determination of what constitutes “adequate” proof and “reasonable” period of time is a matter of interpretation for the courts or arbitral tribunals taking into account the particular circumstances. The Working Group thought that the flexibility introduced with these terms was necessary, since no rule could be found which would be suitable for all possible cases. In addition, in order to avoid any uncertainty that might ensue as a result of the use of these terms, the Working Group decided to include a “safe harbour” rule, according to which a written confirmation from the assignor constitutes adequate proof.

48. The notification does not trigger the obligation to pay, which remains subject to the original contract and the law applicable thereto. This means that the debtor does not have to pay upon notification and does not owe interest for late payment while it awaits the adequate proof requested. If, however, the debt becomes payable within that period in accordance with the original contract, the question arises whether the payment obligation is suspended until the debtor receives such proof and has a reasonable time to assess it and act thereon. If the payment obligation is not suspended, the significance of the protection afforded to the debtor by paragraph (6) may be reduced to the extent that the debtor delaying payment, even for good reasons, would have to pay interest. The Working Group proceeded on the understanding that the payment obligation would be suspended in such cases, but chose not to include any explicit wording in paragraph (6), since that result could be reached without any explicit wording anyway and any additional wording could inadvertently interfere with national law on interest. The Working Group may wish to reconsider this approach. Any uncertainty as to this matter might reduce the usefulness of paragraph (6). It may be preferable to explicitly state that the payment obligation is suspended. In order to avoid suspension of payment which could disadvantage both the assignor and the assignee, the Working Group may wish to consider that, if the debt becomes payable during the period when the debtor awaits proof of the assignee from the assignee, the debtor should discharge its debt by paying the assignor (see A/CN.9/WG.II/WP.104, remark 2 to draft article 19).

49. Paragraph (7) is intended to ensure that draft article 19 does not exclude other ways of discharge of the debtor’s obligation that may exist under national law applicable outside the draft Convention. However, paragraph (7) may inadvertently result in a debtor ignoring a notification given under the draft Convention (e.g., because it relates to future receivables, which may not be allowed under other law) and paying someone else in accordance with other law. For that reason, the Working Group may wish to consider validating payment under other law only if it is made to a legitimate assignee under the draft Convention, while limiting recourse to payment into court and the like to cases involving several

notifications (see A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 19) and, possibly, notification by the assignee. If such an approach were to be followed, paragraph (8) may not be necessary, since, if the debtor, being notified by the assignee, is in doubt as to the validity of an assignment, it could discharge its debt by paying into court.

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Article 20. Defences and rights of set-off of the debtor

REFERENCES

A/CN.9/420, paras. 66-68 and 132-135

A/CN.9/432, paras. 205-209

A/CN.9/434, paras. 194-197

A/CN.9/447, paras. 94-102

A/CN.9/456, paras. 194-199

COMMENTARY

50. Draft article 20 is another particular application of the general principle that the debtor's legal position should not be unduly affected as a result of the assignment. The debtor has against the assignee all the defences and rights of set-off that the debtor could raise against the assignor. What those defences and rights of set-off are is a matter not addressed in the draft Convention but left to other law.

51. Under paragraph (1), the debtor may raise against the assignee all the defences that arise from the original contract, without any limitation, including: contractual claims, which, in some legal systems, might not be considered "defences"; rights for contract avoidance, e.g., for mistake, fraud or duress; exemption from liability for non-performance, e.g., because of an unforeseen impediment beyond the control of the parties; and counter-claims under the original contract. Such defences and rights of set-off may be raised irrespective of whether they are available at the time of notification of the assignment or become available only after such notification. The Working Group may wish to consider the question whether rights of set-off arising from contracts between the assignor and the debtor that are closely related to the original contract (e.g., a maintenance or other service agreement supporting the original sales contract) should be treated in the same way as rights of set-off arising from the original contract.

52. Paragraph (2) introduces a time limitation with regard to rights of set-off arising from any source other than the original contract, i.e. a separate contract between the assignor and the debtor, a rule of law (e.g., a tort rule) or a judicial or other decision. Such rights may not be raised against the assignee if they become available after notification of the assignment. The rationale underlying this rule is that the rights of a diligent assignee who notifies the debtor should not be made subject to rights of set-off arising at any time from separate dealings between the assignor and the debtor or other events, of which the assignee could not be reasonably expected to be aware. On the other hand, the interests of the debtor are not unduly affected, since, if the fact that the debtor cannot accumulate rights of set-off constitutes an unacceptable hardship for the debtor, the debtor can avoid entering into new dealings

with the assignor (as to the question whether the debtor could declare the original contract avoided, see para. 35). In view of the above-mentioned rationale of paragraph (2), rights of set-off arising from separate contracts between the debtor and the assignee are not affected. Such rights can be asserted against the assignee even after notification of the assignment, like rights of set-off arising from the original contract. It should also be noted that a notification results in freezing the debtor's rights of set-off, whether it contains a payment instruction or not. This approach is intended to accommodate practices in which a bare notification is given for the purpose of exactly precluding the debtor from accruing rights of set-off from acts or omissions of the assignor that are beyond the assignee's control, while the debtor is expected to continue paying the assignor. As a result of draft article 12, according to which an assignment made despite an anti-assignment clause would be ineffective as against a sovereign debtor, draft article 20 would not affect the rights of a sovereign debtor.

53. The Working Group considered a suggestion to elaborate on the meaning of the term "available" by stating that a defence or right of set-off cannot be excluded if at the time of notification it is "actual and ascertained". That suggestion was not adopted since it would result in limiting inappropriately the rights of set-off available to the debtor to those that were quantified at the time of the notification. In order to avoid leaving the matter completely unresolved, the Working Group also considered various suggestions as to the law applicable to rights of set-off. Reference was made to the law governing the receivable and to the law of the assignor's location. The Working Group may wish to consider referring instead, at least with regard to contractual rights of set-off, to the law governing the contract from which the right of set-off might arise (see A/CN.9/WG.II/WP.104, remarks 1-2 to draft article 28).

54. Paragraph (3) is intended to ensure that the debtor may not raise against the assignee by way of defence or set-off the breach of an anti-assignment clause by the assignor. The debtor may have a cause of action against the assignor, if, under law applicable outside the draft Convention, the assignment constitutes a breach of contract which results in a loss to the debtor. However, the mere existence of an anti-assignment clause is not a violation of the representation contained in draft article 14 (1) (a). In the absence of a provision along the lines of paragraph (3), draft article 10 (3), holding the assignee harmless for breach of contract by the assignor, could be deprived of any meaning.

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Article 21. Agreement not to raise defences or rights of set-off

REFERENCES

A/CN.9/420, paras. 136-144

A/CN.9/432, paras. 218-238

A/CN.9/434, paras. 205-212

A/CN.9/447, paras. 103-121

A/CN.9/456, paras. 200-204

COMMENTARY

55. In order to obtain more value for their receivables and at a lower cost, assignors normally guarantee as against assignees the absence of defences and rights of set-off by the debtor. Recognizing this practice, draft article 14 (1) (c) provides that such a guarantee exists even in the absence of an agreement between the parties in this regard. In practice, if such representations cannot be given and the receivables are likely to be subject to defences, such receivables are either not accepted by assignees, or are accepted at a significantly reduced value or are accepted only on a recourse basis (i.e. if the assignee cannot collect from the debtors, it has the right to return the receivables to and collect from the assignor). In order to avoid those adverse effects, assignors, as a matter of practice, negotiate with debtors waivers of the defences and rights of set-off that debtors may raise against any future assignee. On the basis of such waivers, assignees determine the credit terms offered to assignors, which in turn are likely to affect the credit terms assignors offer to debtors.

56. With a view to allowing assignors to obtain lower-cost credit, draft article 21 validates such waivers of defences and rights of set-off. Furthermore, in order to avoid uncertainty as to the legal consequences of a waiver and that a court may override it as being unfair to the debtor, paragraph (1) states what may appear obvious in some legal systems, namely that a waiver precludes the debtor from raising defences and rights of set-off against the assignee. In recognition of the fact that in practice a waiver may be agreed upon at the time of the conclusion of the original contract, as well as at an earlier or later time, paragraph (1) does not make specific reference to the point of time at which a waiver may be agreed upon. Paragraph (1) does not make explicit reference to the acceptance of an assignment by the debtor operating as a waiver or as a confirmation of a waiver either. The matter is left to other law. Paragraph (1) does not require either that the defences are known to the debtor or are explicitly stated in the agreement by which the defences are waived. The Working Group thought that such a requirement would introduce an element of uncertainty, since the assignee would need to establish what the debtor knew or could have known in each particular case.

57. While aimed at facilitating increased access to lower-cost credit, which is in the interest of trade in general, draft article 21 does not neglect the protection of the debtor. In order to protect debtors from undue pressure by creditors so as to waive their defences, paragraph (2) introduces reasonable limitations with respect to such waivers of defences. Such limitations refer to the form in which such waivers can be made, to certain types of debtors and to certain types of defences. In view of the fact that the scope of paragraph (1) is limited to waivers agreed upon by the assignor and the debtor, the limitations contained in paragraph (2) do not apply to waivers agreed upon by the debtor and the assignee. The Working Group thought that the draft Convention should not limit the debtor's ability to negotiate with the assignee in order to obtain a benefit, such as a lower interest rate or a longer payment period. At the same time, the Working Group also thought that, in view of the fact that agreements between assignees and debtors are outside the scope of the draft Convention, the draft Convention should not empower the debtor to negotiate waivers with assignees, if, under the law applicable, the debtor would not have such a power.

58. Paragraph (1) introduces further limitations. A waiver cannot be a unilateral act or an oral agreement; it has to take the form of a signed written agreement, so as to ensure that both parties are well informed about the fact of the waiver and its consequences, including the benefits offered to the debtor in return, and to facilitate evidence. In addition, a waiver cannot override the consumer-protection law prevailing in the country in which the debtor has its location (which in this context is to be understood as the place of business). In order to avoid terminological and other differences existing

among the various legal systems, paragraph (1) refers to debtors in transactions for “personal, family or household purposes”. Such reference is qualified by the term “primarily”, so as to ensure that the limitation would apply only to transactions for purely consumer purposes (i.e. transactions between consumers) and not to transactions for both consumer and commercial purposes (i.e. transactions between a consumer and a business entity). The Working Group may wish to reconsider this approach. It would appear to be consistent with the purpose of protecting consumer debtors to apply this provision to a transaction serving consumer purposes with respect to one party and commercial purposes from the perspective of the other party (the same would be true in the context of draft article 23 but not in the context of draft article 4; see para. 70 and A/CN.9/WG.II/WP.105, para. 43).

59. Moreover, under paragraph (2), a waiver cannot relate to defences arising from fraudulent acts committed by the assignee. Such a result would run counter to basic good faith standards. With a view to protecting an assignee who accepts an assignment in good faith, the Working Group decided not to apply the same limitation to defences relating to fraud by the assignor. If the debtor could not waive such defences, the assignee would have to investigate in order to ensure that no fraud was committed by the assignor in the context of the original contract. The limitation under paragraph (2), however, applies not only to defences relating to fraud by the assignee alone but also to defences relating to fraud by the assignee in collusion with the assignor. In this context, the Working Group considered other defences that should not be waived. In order to accommodate certain export transactions, the Working Group decided that the defence relating to the invalidity of the original contract should be made subject to a waiver. As to defences against the protected holder of a negotiable instrument, relating to signature requirements and agency (article 30 (1) (c) of the United Nations Convention on International Bills of Exchange and International Promissory Notes), the Working Group thought that no parallel should be drawn between a receivable and a negotiable instrument. Such a parallelism would not be in line with draft article 4 (1) (b) which excluded the transfer of instruments by endorsement and delivery or by mere delivery. It would also be inconsistent with the will of the parties who chose not to incorporate their receivables into a negotiable instrument.

60. In line with paragraph (1), paragraph (3) requires for the modification of a waiver the form of a signed written agreement. Parties need to be warned of the legal consequences of such a modification, which should be easily proven, if necessary. With a view to ensuring that a modification, which may be agreed upon by the assignor and the debtor, does not affect the rights of the assignee, paragraph (3) subjects a modification to the procedure foreseen in draft article 22 (2) for the modification of the original contract after notification of the assignment (i.e. to actual or constructive consent by the assignee; see para. 65).

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Article 22. Modification of the original contract

REFERENCES

A/CN.9/420, para. 109

A/CN.9/432, paras. 210-217

A/CN.9/434, paras. 198-204

A/CN.9/447, paras. 122-135

A/CN.9/456, paras. 205-206

COMMENTARY

61. The modification of the original contract is an issue that arises frequently in practice. A modification may be necessary for various reasons. For example: a substantial change in the main circumstances under which the contract was concluded may make it unfair for the assignor to deliver the goods as promised; equipment or materials different from the ones agreed may be necessary in the construction of a project; or a change in the general circumstances may require an extension of the deadline for payment agreed upon in the original contract. To the extent that such contract modifications raise issues relating to rights and obligations as between the assignor and the debtor or as between the assignor and the assignee, they are generally addressed in the relevant contract or in legislation. However, to the extent that such contract modifications raise the question of the rights and obligations as between the assignee and the debtor, the relevant issues may not be fully addressed either in contract or in legislation.

62. The primary goal of draft article 22, therefore, is to ensure that the debtor has as against the assignee the right to modify the original contract in the sense that, in the case of reduction in the price, the debtor is discharged by paying the reduced price and does not owe the price of the original receivable. However, draft article 22 is not intended to interfere with the relationship between the assignor and the debtor. For this reason, the requirements and the legal consequences of an effective modification agreement as between the assignor and the debtor remain subject to the law governing that agreement. A secondary goal of draft article 22 is to protect the assignee by ensuring that the assignee acquires rights under the modified original contract. This means that, if the price of the goods or services offered under the original contract is modified, the debtor may not raise the modification of the contract as a defence, asserting that the assignee has no rights under the new modified contract, and refuse to pay even the reduced price (any rights that the assignee might have against the assignor, however, for breach of contract are not affected; see para. 67).

63. The basic rule introduced by draft article 22 is that, before notification, the assignor and the debtor may freely modify their contract. They do not need to obtain the consent of the assignee, even though the assignor may have undertaken in the assignment contract to abstain from any contract modifications without the consent of the assignee or may be under the good faith obligation to inform the assignee about a contract modification. The breach of such an undertaking may give rise to liability of the assignor as against the assignee. It does not, however, invalidate an agreement modifying the original contract, since such an approach would inappropriately affect the rights of the debtor. After notification, a modification of the original contract becomes effective as against the assignee only subject to the actual or constructive consent of the assignee. The underlying rationale is that, after notification, the assignee becomes a party to a triangular relationship and any change in that relationship which affects the assignee's rights should not bind the assignee against its will. This approach is in line with draft article 19, according to which, before notification, the debtor may discharge its obligation in accordance with the original contract.

64. Paragraph (1) requires an agreement between the assignor and the debtor, which is concluded before notification of the assignment and affects the assignee's rights. If the agreement does not affect the rights of the assignee, paragraph (1) does not apply. If the agreement is concluded after notification, paragraph (2) applies. The Working Group may wish to specify that the relevant point of time is the time when notification is received by the debtor, since as of that time the debtor may discharge its obligation only in accordance with the assignee's payment instructions.

65. Paragraph (2) is formulated in a negative way, since the rule is that, after notification, a modification is ineffective as against the assignee, unless an additional requirement is met. "Ineffective" means that the assignee may claim the original receivable and the debtor is not fully discharged by paying less than the value of the original receivable. Paragraph (2) requires actual or constructive consent of the assignee. Actual consent is required if the receivable has been fully earned by performance and the assignee has thus the reasonable expectation that it will receive payment of the original receivable. For the purposes of the draft Convention, a receivable is considered as being fully earned when an invoice is issued, even if the relevant contract has only partially been performed. As a result, for such partially performed contracts to be modified, the actual consent of the assignee is required. Constructive consent exists if the original contract allows modifications or a reasonable assignee would have given its consent. Such a consent is sufficient if the receivable is not fully earned and the modification is foreseen in the original contract or a reasonable assignee would have consented to such a modification. In requiring actual or constructive consent, the Working Group intended to combine certainty with flexibility. If a receivable is fully earned, its modification affects the reasonable expectations of the assignee and has thus to be subject to the consent of the assignee. If, on the other hand, a receivable is not fully earned, there is no need to overburden the parties with requirements that may affect the efficient operation of a contract. In particular, in long-term contracts, such as project financing or debt-restructuring arrangements (in which receivables are offered as security in return for a reduction in the interest rate or an extension of the maturity date), a requirement that the assignor would have to obtain the assignee's consent to every little contract modification could slow down the operations while creating an unwelcome burden for the assignee. This problem, however, would normally not arise, since in practice parties tend to resolve such issues through an agreement as to which types of modifications require the assignee's consent. In the absence of such an agreement or in the case of breach of such an agreement by the assignor, paragraph (2) would provide an adequate degree of protection to the debtor.

66. The Working Group chose not to refer to general principles, such as good faith or reasonable commercial standards, in order to justify a modification. Those standards were thought to be introducing an undesirable degree of uncertainty, since there is no uniform understanding as to their meaning. The Working Group was not favourable either to limiting the situations in which the assignee's consent would be necessary to those in which a modification of the original contract would result in "material adverse effects" to the assignee.

67. Paragraph (3) is intended to preserve any right of the assignee as against the assignor if a modification of the original contract violates an agreement between the assignor and the assignee. This means that, if a modification is effective as against the assignee, without the assignee's consent, the debtor is discharged by paying in accordance with the contract as modified. The assignee, however, may turn against the assignor and claim the balance of the original receivable and compensation for any

additional damage suffered, if the modification is in breach of an agreement between the assignor and the assignee.

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Article 23. Recovery of payments

REFERENCES

A/CN.9/420, paras. 145-148

A/CN.9/432, paras. 239-244

A/CN.9/434, paras. 94 and 213-215

A/CN.9/447, paras. 136-139

A/CN.9/456, paras. 207-208

COMMENTARY

68. In practice, the debtor may pay the assignee before the assignor performs its obligations under the original contract. If the assignee does not perform, the question arises whether the debtor may recover from the assignee the sums paid. This question is of particular importance if the assignor becomes insolvent and thus recovery of payments from the assignor is impossible.

69. As a complement to the principle that the debtor's legal position should not be worsened as a result of the assignment, draft article 23 provides that the debtor's position should not be improved either. If the debtor pays the assignee and the assignor does not properly perform the original contract, the debtor has recourse against the assignor under the original contract and the law governing that contract, but not against the assignee. This means that the debtor bears the risk of insolvency of its contractual partner, which would be the case anyway in the absence of an assignment. Noting that a different approach is followed in the Ottawa Convention, the Working Group thought that the difference was justified. A guarantee of performance of the original contract by the assignee may be appropriate in the specific factoring situations addressed in the Ottawa Convention, but was thought to be inappropriate in the context of other financing or service transactions, including factoring transactions which had a predominant service element.

70. There are certain limitations to the rule contained in draft article 23. Under consumer-protection law, the consumer debtor might have the right to declare the original contract avoided and to recover from the assignee any payments made to the assignee. The Working Group thought that the draft Convention should not override the consumer-protection law prevailing in the country in which the debtor is located (i.e. has its place of business; as to the meaning of the term "primarily" and the problem arising in this context, see para. 58). The Working Group also thought that a general reference to public policy in this context would not be necessary. The notions of public policy and mandatory law would apply under draft articles 30 and 31 through the mechanism of private international law rules, providing wide recognition of law applicable outside the draft Convention. The Working Group also thought that multiple references to public policy and mandatory law could inappropriately widen the scope of the limitation and detract from the certainty achieved in the draft Convention.

71. A second limitation is introduced to the rule contained in draft article 23 through the reference to draft article 20. This reference is intended to ensure that the debtor's defences and rights of set-off are preserved with regard to payment in installments, where some installments have been made while other installments are outstanding. Such rights would only apply where the debtor would need to reduce or avoid payment of outstanding installments.

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Section III. Other parties

Article 24. Competing rights of several assignees

REFERENCES

A/CN.9/420, paras. 149-164
A/CN.9/432, paras. 245-260
A/CN.9/434, paras. 238-254
A/CN.9/445, paras. 18-29
A/CN.9/455, paras. 18-31
A/CN.9/456, paras. 209-210

COMMENTARY

72. In practice, receivables may be assigned several times. Such "duplicate assignments" are normal practice in the case of assignments by way of security in which different parts of the same receivables are offered as security for credit. In such a case, the question arises what is the order of priority in payment among the various claimants. Priority does not mean validity. It presupposes a valid assignment (substantive or material validity is dealt with in chapter III, while formal validity is left to law applicable outside the draft Convention; for a Secretariat suggestion to deal in the draft Convention with formal validity as well, see A/CN.9/WG.II/WP.104, remarks to chapter III). Priority does not prejudice either the issue whether the assignee with priority will retain all the proceeds of payment or turn over any remaining balance to the assignor or to the next claimant in the order of priority. This matter depends on whether an outright assignment or an assignment by way of security is involved, a matter left to law applicable outside the draft Convention. Priority does not affect the discharge of the debtor either. The debtor paying in accordance with draft article 19 (or, if draft article 19 is not applicable, in accordance with the law applicable under draft article 28) is discharged, even if payment is made to an assignee who does not have priority (under draft article 24 or, if draft article 24 is not applicable, under draft article 29). Whether that assignee will retain the proceeds of payment is a matter of priority to be resolved among the various claimants in accordance with the law applicable under draft article 24 (or draft article 29).

73. However, several outright assignments of the same receivables made by the same assignor may be a fraudulent or an unconscionable act. While fraud is a rare occurrence, simple inadvertence on the part of the assignor, or ignorance of the legal effects of a previous assignment, occurs frequently. A typical example is the assignment to a receivables financier in return for working capital and to an inventory financier or to a supplier of materials on credit with a retention of title or other security interest until full payment of the price of the inventory or of the materials. In such a case, the conflict may be between a

global assignment (an assignment of all present and future receivables) to the receivables financier and an assignment to the inventory financier or the supplier of the proceeds from the sale of the inventory or materials. With a view to achieving certainty with regard to the rights of the various creditors of the assignor and thus facilitating the assignor's access to credit, the Working Group proceeded with its work on the assumption that such conflicts would be addressed. If the assignment to the inventory financier or to the supplier is contractual, such conflicts are clearly within the scope of the draft Convention. However, this may not be the case, if the assignment occurs by operation of law, since, under draft article 2 (1), the draft Convention covers only assignments by way of agreement and not by operation of law. The Working Group may, therefore, wish to clarify that any conflicts of priority between an inventory financier or a supplier with a statutory right in any proceeds and an assignee comes under the ambit of the draft Convention. In this context, the Working Group may also wish to consider whether the priority rules of the draft Convention are appropriate in the case of a conflict between an assignee and a supplier. In many legal systems, irrespective of the priority rules applicable, suppliers have priority over assignees obtaining rights by way of global assignments.

74. Draft article 24 is intended to apply to a conflict between a Convention and a non-Convention assignee (e.g., between a domestic and a foreign assignee of domestic receivables). Such an approach would not affect domestic practices. In fact, one of the reasons for which the Working Group decided to turn the priority rules into private international law rules was that such rules would not negatively affect domestic practices. The domestic assignee would have to meet the requirements of the same law, since by definition, in a conflict with a foreign assignee, the domestic assignee, the assignor and the debtor would be located in the same jurisdiction. Assuming that the draft Convention defines "location" of a legal entity by reference to its place of incorporation or place of central administration and that that place is different from the place of business, the applicable law may be different. However, even in such a case the domestic assignee could predict that the draft Convention could apply, since: the domestic assignee would be located in a Contracting State (the same State in which the assignor is located; otherwise the draft Convention would not apply); and the domestic assignee would know that the assignor is, for example, a branch of a foreign entity. The Working Group may wish to confirm this understanding (see also A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 1).

75. In the case of several outright assignments of the same receivables by the same assignor the issue may not be who will receive payment first (i.e. an issue of priority) but who will receive payment at all (i.e. an issue of effectiveness). In such assignments, the assignee with "priority" takes all the proceeds (provided that it has a valid claim) and no other assignee can obtain payment. However, the draft Convention does not differentiate between outright assignments and assignments by way of security, since: third parties may have no way of knowing whether an assignment by way of security or an outright assignment is involved in a particular case; and, in any case, such differentiation would be very difficult in view of the wide divergences existing among the various legal systems with regard to security rights.

76. Draft article 24 contains a private international law rule subjecting priority issues to the law of the assignor's location (the meaning of the term "location" has not been decided yet by the Working Group; for the Secretariat's suggestions, see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5). The Working Group recognized that a private international law rule cannot lead to uniformity in terms of commercial results, since one law may give priority to the first assignee in time, while another law may give priority to the first assignee to notify the debtor or to register certain data about the assignment. However, the Working Group also recognized that there is clear commercial value in a private

international law rule that would subject priority issues to the law of a single and easily determinable jurisdiction. Such a rule would constitute a significant improvement of the present situation in which assignees tend to either reject international receivables as security for credit or to accept them at a low value, since they either cannot determine which law may govern priority or they have to meet the requirements of several jurisdictions in order to ensure that they will have priority.

77. If, under the applicable law, priority is based on the time of assignment, an assignee considering whether to finance certain receivables has to rely on the assignor's representations and possibly on representations made by other parties or on information available in a certain market. If the applicable law determines priority based on priority in notification of the debtor, again a prospective assignee has to rely on representations by the assignor and by the debtor, as well as on information available from other sources. In such jurisdictions: priority with regard to future receivables will not be obtainable at all at the time of assignment (at that time the identity of the debtors is not known); and priority with regard to receivables assigned in bulk will only be obtainable at the additional cost of notifying all the debtors. If, on the other hand, under the law applicable, priority is obtained by way of making certain data part of a public record, beyond representations by the assignor or other parties, prospective assignees would have that public record to rely on. In addition, assignees filing the required data would have an objective way of acquiring priority.

78. In this context, the Working Group may wish to clarify that, if, under the law of the assignor's location (which must be in a Contracting State for the draft Convention to apply), priority is determined on the basis of the time of notification of the debtor, the notification needs to be given in accordance with the draft Convention. If notification were to be given in accordance with the domestic law of the assignor's location and that law invalidates notifications relating to future receivables, assignees would be unable to establish priority with regard to future receivables, a result that would have a negative impact on the availability and the cost of credit (see para. 36).

79. Departing from the approach traditionally followed in many legal systems, subjecting priority issues to the *lex situs* of the receivable (the law of the country where payment is due or the debtor is located), the Working Group decided to subject priority issues to the law of the assignor's location. The Working Group took this approach, considering that the traditional rule is no longer regarded as a workable or efficient rule. In the increasingly common case of a global assignment of present and future receivables (e.g., under factoring, invoice discounting or securitization agreements) application of the law of the *lex situs* of the receivable fails to yield a single governing law. It also exposes prospective assignees to the burden of having to determine the notional *situs* of each receivable separately. Application of the law governing the receivable or of the law chosen by the parties produces similar results. Different priority rules would govern priority with regard to the various receivables in a pool of receivables and, in the case of future receivables, the parties would not be able to determine with any certainty the law applicable to priority, a factor that may defeat a transaction or, at least, raise the cost of credit. Application of the law chosen by the assignor and the assignee in particular could allow the assignor, acting in collusion with a claimant in order to obtain a special benefit, to determine the priority among several claimants. In addition, the law chosen by the parties would be completely unworkable in the case of several assignments of the same receivables either by the same or by different assignees, since different laws could apply to the same priority conflicts.

80. Whether location is defined by reference to the place of incorporation or of the place of central administration of a legal entity, application of the law of the assignor's location will result in the application of the law of a single jurisdiction and one that can be easily determined at the time of assignment. It will thus eliminate the difficulties mentioned above. Furthermore, application of the law of the assignor's location will be particularly compatible with the law of jurisdictions with public registration requirements in which third parties would normally look at the law of the assignor's location to determine the manner in which they could establish priority.

81. The Working Group considered the question of the point of time which should be taken into account in the determination of the location of the assignor. If the assignor relocated after one and before another assignment, the assignee with priority under the law of the initial location should not lose its priority. On the other hand, the right of claimants in the new location should not be forever subject to the rights of claimants from other jurisdictions. However, it was widely felt that relocation of the assignor between duplicate assignments occurred rarely in practice and a rule aimed at addressing the issue would make draft article 24 unnecessarily complex. The Working Group, therefore, decided to leave the matter to other law applicable outside the draft Convention.

82. As mentioned above, the Working Group decided to depart from the traditional approach in order to accommodate the most common practices that involve bulk assignments of all present and future receivables. The Working Group decided that no exception should be made for assignments of single, high-value, existing receivables. Introducing a different priority rule with regard to the assignment of such receivables would detract from the certainty achieved in draft article 24. It would be very difficult to clearly define "high-value receivables". In addition, in a bulk assignment containing both "high-value" and "low-value" receivables, priority would be subject to different laws.

83. In the context of its discussion of the law applicable to priority issues, the Working Group considered the question of potential conflicts with the Convention on the Law Applicable to Contractual Obligations (Rome, 1980; hereinafter referred to as "the Rome Convention"), whose article 12 deals with the law applicable to assignment. The Working Group thought that the reference to a regional instrument applicable to contractual obligations should not prevent the preparation of a specialized legal regime for universal application to financing and service transactions. The Working Group also took note of the fact that great uncertainty exists as to whether article 12 of the Rome Convention addresses priority issues and, if so, whether the law applicable is the law chosen by the parties or the law governing the receivable. The Working Group thought that it would be useful to resolve this uncertainty and that, in any case, priority issues (i.e. the proprietary effects of an assignment) should not be made subject to the law governing the receivable or to the law chosen by the parties (see paras. 79-80 and 88). It was agreed, however, that States should have the right to settle any conflict between the draft Convention and the Rome Convention by determining which text they wish to give precedence to (draft article 33).

84. While draft article 24 subjects priority conflicts between several assignees who obtain the same receivables from the same assignor to the law of the assignor's location, it recognizes the interest of the parties involved in a conflict to negotiate and to relinquish priority in favour of a subordinate claimant where commercial considerations so warrant. In order to afford maximum flexibility and to reflect prevailing business practices, paragraph (2) was drafted to make it clear that a valid subordination need not take the form of a direct subordination agreement between the assignee with priority and the

beneficiary of the subordination agreement. It can also be effected unilaterally, e.g., by way of an undertaking of the first ranking assignee to the assignor (whether in the contract of assignment or an independent, written or oral, agreement), empowering the assignor to make a second assignment ranking first in priority. The term “unilaterally” is further intended to clarify that the beneficiary of the subordination (the second assignee) need not offer consideration in exchange for the priority granted by the unilateral subordination. Furthermore, paragraph (2) clarifies that an effective subordination need not specifically identify the intended beneficiary or beneficiaries (“any existing or future assignees”) and can instead employ generic language.

85. The Working Group also considered several alternatives of a substantive law priority rule but failed to reach agreement. For this reason, two alternative substantive law priority rules are offered in the annex to the draft Convention for States to choose from. As a result, States might be confused as to what is the recommended approach. In addition, if a State does not choose any of those two alternatives (e.g., because its priority regime is based on priority in time of notification of the debtor), the full range of alternatives will, in effect, be reproduced. Moreover, the annex would need further development so as to be workable. In view of the above, the Working Group may wish to consider replacing the annex with a few general principles referring the matter of preparing model priority provisions to the procedure for the revision and amendment of the draft Convention (see A/CN.9/WG.II/WP.104, remarks to the annex).

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Article 25. Competing rights of assignee and creditors of the assignor or insolvency administrator

REFERENCES

A/CN.9/420, paras. 149-164
A/CN.9/434, paras. 216-237 and 255-258
A/CN.9/445, paras. 30-44
A/CN.9/455, paras. 32-40
A/CN.9/456, paras. 211-222

COMMENTARY

86. Draft article 25 is intended to settle conflicts of priority between an assignee and creditors of the assignor or the administrator in the insolvency of the assignor. The draft Convention is not intended to address issues arising in the case of insolvency of the assignee, unless the assignee makes a subsequent assignment and becomes an assignor. The Working Group thought that such issues are beyond the scope of the draft Convention. The draft Convention is not intended to address issues arising in the context of the debtor’s insolvency either. It is assumed that the assignee would have in the receivables the same rights that the assignor would have in the case of insolvency of the debtor. As already mentioned, priority is defined as a preference (in payment or other discharge; see A/CN.9/WG.II/WP.105, para. 57). The exact legal consequences of such preference depend on whether an assignment by way of security or an outright assignment is involved, a matter left to law applicable outside the draft Convention. In any case, preference established under the draft Convention

is not intended to interfere with special preference or super-priority rights existing under national insolvency law (see para. 93).

87. Conflicts of priority covered by draft article 25 may arise if the assignment is made before attachment or commencement of an insolvency proceeding (if the assignment is made thereafter, no conflict arises; any rights that the assignee may obtain are subordinate to the rights of the assignor's creditors or the insolvency administrator). If priority is based on the time of assignment, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is sufficient to establish that the receivables are separated from the assignor's estate (if an outright assignment is involved) or that the assignee may satisfy its claim in preference to unsecured creditors (if an assignment by way of security is involved). If, however, priority is determined on the basis of notification of the debtor or registration of certain data about the assignment in a public registry, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is not sufficient for the purpose of establishing priority. Notification of the debtor or registration needs also to take place before attachment or commencement of the insolvency proceeding.

88. Draft article 25 subjects such priority conflicts to the law of the assignor's location (the issue of the meaning of the assignor's location has not been decided yet; see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5). As already mentioned (see paras. 79-80), the location of the assignor as a connecting factor presents the advantage of simplicity and predictability for a number of reasons, including that: it provides a single point of reference; it could be ascertained at the time of even a bulk assignment of future receivables; it would be suitable even for legal systems in which registration is practiced; and it would result in the application of the law of the jurisdiction in which any insolvency proceeding with regard to the assignor would be most likely to commence. This last aspect of the application of the law of the assignor's location is essential, since it appropriately addresses the issue of the relationship between the draft Convention and the applicable insolvency law. Indeed the thrust of draft article 25 is to ensure that, in most cases, the law governing priority under draft article 25 and the law governing the insolvency of the assignor are the laws of one and the same jurisdiction (the assignor's main jurisdiction, whether place of incorporation or of central administration). In such a situation, any conflict between the draft Convention and the applicable insolvency law would be resolved by the rules of law of that jurisdiction. In all other cases in which an insolvency proceeding with regard to the assets and affairs of the assignor is commenced in a State other than the State of the assignor's main jurisdiction (e.g., a jurisdiction in which the assignor has assets), the draft Convention gives way to rules of law that reflect the public policy of the State in which a dispute is adjudicated, either before a court or an arbitral tribunal (draft article 25 (3)). In addition, in such cases, the draft Convention is intended to avoid any interference with certain rights of the assignor's creditors or of the insolvency administrator, which, although not reflective of public policy, are part of mandatory law (draft article 25 (4)). The Working Group may wish to extend the application of those two limitations to court proceedings outside insolvency. In any case, non-consensual, preferential rights would not be affected (draft article 25 (5)).

89. The public policy meant in paragraph (3) is the international public policy of the forum State. Recourse to such public policy has only a negative effect in the sense that it may defeat the application of a provision of the law applicable under draft article 25 which is manifestly contrary to the public policy of the forum State (e.g., a rule giving priority to a foreign State for taxes). As a result, a certain person may be bypassed in the determination of priority, while priority will be determined by other provisions of the applicable law. The public policy of draft article 25, however, may not have a positive

effect; it may not result in the positive application of a priority rule of the forum State which reflects public policy (e.g., a rule giving priority to employees in the forum State). For that reason, the Working Group decided to include paragraph (5) in draft article 25, specifically preserving non-consensual, super-priority rights (see para. 93).

90. For a priority rule to be set aside under paragraph (3), it must be “manifestly contrary” to the public policy of the forum State. The notion of “manifestly contrary” is used in international texts (including article 6 of the UNCITRAL Model Law on Cross-Border Insolvency, article 16 of the Rome Convention and article 18 of the Inter-American Convention on the Law Applicable to International Contracts) as a qualification of public policy. The purpose of such a qualification is to emphasize that public policy exceptions should be interpreted restrictively and paragraph (3) should be invoked only in exceptional circumstances concerning matters of fundamental importance for the forum State. Otherwise, the certainty achieved by draft article 25 could be seriously compromised, a result that would have a negative impact on the availability and the cost of credit on the basis of receivables (the term “manifestly contrary” is used also in draft article 31; see para. 114).

91. If the rule, with which the priority rule of the law applicable conflicts, falls short of being reflective of public policy but is a rule of mandatory law, under paragraph (4) special rights of creditors of the assignor and of the insolvency administrator are not affected “except as provided by this article”. These words mean that the priority rule of the law applicable is not set aside; it applies to the extent that it does not affect certain special rights. The rationale underlying this approach is that the priority rules of the law applicable are themselves mandatory rules and setting them aside in favour of mandatory rules of the forum would result in uncertainty and thus have a negative impact on the availability and the cost of credit. At the same time, however, the Working Group recognized that an exception should be made for cases in which special rights of the assignor’s creditors or of the insolvency administrator are affected.

92. Such special rights include, but are not limited to, any right of creditors of the assignor to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer. They also include any right of the insolvency administrator: to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment as a fraudulent or preferential transfer; to avoid or otherwise render ineffective, or to initiate an action to avoid or otherwise render ineffective, an assignment of receivables that have not arisen at the time of the commencement of the insolvency proceeding; to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract, or to encumber the assigned receivables with the expenses of the insolvency administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee. If the assigned receivables constitute security for indebtedness or other obligations, the special rights protected under paragraph (4) include any rights existing under insolvency rules or procedures generally governing the insolvency of the assignor that: permit the insolvency administrator to encumber the assigned receivables; provide for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding; permit the substitution of the assigned receivables for new receivables of at least equal value; provide for the right of the insolvency administrator to borrow using the assigned receivables as security to the extent that their value exceeds the obligations secured. They also include other rules and procedures of similar effect and of general

application in the insolvency of the assignor specifically described by a Contracting State in a declaration (draft article 25 (5)).

93. As already mentioned, the forum State may, under paragraph (3), refuse to give priority, for example, to a foreign State for taxes, but may not apply its own priority rule giving priority to employees in the forum State. Paragraph (5) is intended to achieve exactly this result, namely to allow the forum State to apply its own priority rules, in the case where a priority rule applicable under paragraphs (1) and (2) is manifestly contrary to the forum's public policy, and to give priority to non-consensual rights reflecting the forum's public policy (for paragraphs (5) and (6), see A/CN.9/WG.II/WP.104, remarks 2-3 to draft article 25). Paragraph (5) goes a step further. It allows a State to list in a declaration the non-consensual, super-priority rights that should prevail over the rights of an assignee under the draft Convention. This possibility for declarations is intended to enhance certainty in that it provides a mechanism for assignees to know which super-priority rights would prevail over their rights. It is formulated as a possibility (not as an obligation) and it appears within square brackets, since the Working Group thought that it might reduce the acceptability of the draft Convention, in particular to the extent that a declaration would have the effect of limiting the national super-priority rights that would be preserved (for a Secretariat suggestion to delete the bracketed language in paragraph (5), see A/CN.9/WG.II/WP.104, remark 2 to draft article 25).

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[Article 26. Competing rights with respect to payments

REFERENCES

A/CN.9/447, paras. 63-68

A/CN.9/456, paras. 160-167

COMMENTARY 1/

94. Draft article 26 has a twin goal, to ensure that the assignee has with respect to proceeds the same priority as in the receivables and, at the same time, to grant the assignee with respect to a limited type of proceeds and under certain conditions the same *in rem* rights that the assignee has in the receivables. Proceeds are described as everything that is given in payment of the receivables. They include proceeds of proceeds, while payment includes both payment in cash and in kind (e.g., goods returned by the debtor to the assignor).

95. The *in rem* nature of the right in proceeds is an issue that is distinct from the issue of priority. A claimant with priority in accordance with the law applicable under the draft Convention will obtain payment first and will prevail over another claimant (other than a claimant with a super-priority, non consensual right; see draft article 25 (5)) whether that other claimant has a right *in rem* or *ad personam* (for this reason the Secretariat suggests to treat those issues in separate provisions; see

1/ In view of the tentative character of draft article 26, the commentary on this provision is brief. The complete commentary will be written after the finalization of this provision by the Working Group.

A/CN.9/WG.II/WP.104, remarks to draft article 26). However, the *in rem* nature of the right of a claimant with respect to proceeds may be decisive in the case of insolvency. If the claimant with priority has a right *in rem* with respect to proceeds, that claimant will be able to separate the proceeds from the insolvency estate (if an outright assignment is involved) or be treated as a secured creditor and receive payment before unsecured creditors (if an assignment by way of security is involved). If, on the other hand, a claimant with priority has a right *ad personam*, it will receive payment proportionately with other unsecured creditors, if there is any balance left after payment of any creditors with special privileges and security rights.

96. Under paragraph (1), the assignee with priority who receives payment may retain that payment. The implicit limitation, which may need to be stated explicitly, is that the assignee may not retain more than the value of its receivable (as to this matter and the question of interest, see A/CN.9/WG.II/WP.104, remark 3 to draft article 26). Paragraph (2) is intended to grant the assignee an *in rem* right in certain types of proceeds (i.e. cash proceeds) and only under certain conditions (i.e. if the assignor receives payment on behalf of the assignee and keeps those proceeds separated from its own assets). This limited provision is aimed at facilitating practices, such as undisclosed invoice discounting and securitization, to the extent that a right *in rem* with respect to proceeds will increase certainty as to payment to the assignee, in particular in the case of insolvency. Such a provision could have a significantly positive impact on the availability and the cost of credit (for a Secretariat suggestion to extend the application of this provision to other types of proceeds if the conditions set forth in paragraph (2) are met, see A/CN.9/WG.II/WP.104, remark 2 to draft article 26).

97. Paragraphs (3) to (5) deal with the issue of priority in proceeds. They are based on a distinction between proceeds that are receivables and other types of proceeds (e.g., goods). The rule embodied in those paragraphs is that priority in proceeds that are receivables is governed by the law of the assignor's location, while priority in other types of assets is governed by the *lex rei sitae*. With regard to receivables, the Working Group has been able to replace the *lex situs* of the receivable with the law of the assignor's location. The main reason for this approach is that the application of the *lex situs* of the receivable would produce unworkable results, since: in the case of future receivables, the *lex situs* would not be known at the time of the assignment; and, in the case of bulk assignments, priority issues with regard to the same pool of receivable would be subject to different laws. As to proceeds in the form of tangible assets, the Working Group has not found it possible to depart from the *lex rei sitae*, since such an approach could frustrate the expectations of third parties in the country where the asset is located.

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CHAPTER V. CONFLICT OF LAWS

REFERENCES

A/CN.9/420, paras. 185-187

A/CN.9/445, paras. 52-55

A/CN.9/455, paras. 67-73

COMMENTARY

98. Chapter V is intended to state a few general principles that are widely adopted but not recognized in all legal systems. It is not intended to deal with all assignment-related issues in an exhaustive way, or to displace or to contradict any international legislative text existing in this field of law. In particular, draft articles 27 and 28 reflect the generally accepted principles: that the assignment contract is subject to the law chosen by the assignor and the assignee; and that the relationship between the assignee and the debtor is subject to the law governing the receivable. Draft articles 30 and 31 also reflect generally accepted principles that the applicable law may be set aside if it is manifestly contrary to mandatory law or public policy.

99. If the Working Group decides that this chapter may apply irrespective of the scope provisions of the draft Convention, if the forum is in a Contracting State (see A/CN.9/WG.II/WP.104, remarks to chapter V), chapter V would broaden the scope of application of the innovative priority rules of the draft Convention. Unlike draft articles 27, 28, 30 and 31, the priority rule contained in draft article 29 breaks new ground in that it addresses an issue which is not clearly or appropriately resolved in current law. In line with draft articles 24 to 26, draft article 29 subjects priority issues to the law of a single and easily determinable jurisdiction, i.e. the law of the assignor's location (for an analysis of the advantages of this approach, see paras. 79-80 and 88).

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Article 27. Law applicable to the contract of assignment

REFERENCES

A/CN.9/420, paras. 188-196

A/CN.9/445, paras. 52-74

A/CN.9/455, paras. 67-119

COMMENTARY

100. Draft article 27 is intended to reflect the principle of party autonomy with the respect to the law applicable to the contract of assignment. While being widely recognized, this principle is not known in all legal systems. Under paragraph (1), the assignor and the assignee may agree on the law applicable to the contract of assignment. The conclusion, the validity and the rights and obligations of the assignor and the assignee arising under the contract of assignment are intended to be covered by the expression "contract of assignment" (for a suggestion to state this result explicitly, see A/CN.9/WG.II/WP.104, remarks to draft article 27). However, if the assignment is just a clause in the financing contract, this expression is not intended to cover the financing contract as a whole.

101. Paragraph (1) provides that the choice of law must be express. The Working Group recognized that an implicit choice would be in line with current trends in private international law. However, it was

widely felt that a different approach is warranted in the case of financing transactions, in which certainty is of utmost importance and may determine whether a transaction will take place and at what cost.

102. Paragraph (2) deals with the exceptional situations in which the parties have not agreed on the law applicable to the contract of assignment or in which the parties have agreed but their agreement is later found to be invalid. It refers to the closest-connection test, which may result in the application of the law of the assignor's location (e.g., in the case of an assignment by way of sale) or of the law of the assignee's location (e.g., in an assignment by way of security made in the context of a credit transaction). In an attempt to combine flexibility with certainty, paragraph (2) introduces a rebuttable presumption that the State with the closest connection to the contract is the law of the assignor's location. Location in this context means place of business. In view of the limited scope of application of paragraph (2), the Working Group thought that such a reference to the place of business would not undermine the certainty necessary for financing transactions.

103. Paragraph (3) is intended to reflect the generally accepted principle that the parties to a contract may not set aside mandatory rules of the law applicable in the absence of a choice of law by the parties, if the contract is connected with one other State only.

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Article 28. Law applicable to the rights and obligations of the assignee and the debtor

REFERENCES

A/CN.9/420, paras. 197-200

A/CN.9/445, paras. 65-69

A/CN.9/455, paras. 92-104 and 117

COMMENTARY

104. In line with the principle that the draft Convention should not change the legal position of the debtor, draft article 28 reflects a generally acceptable rule, providing that the relationship between the assignee and the debtor is subject to the law governing the receivable. In the case of contractual receivables, that law would be the law governing the original contract, which is likely to be the law chosen by the assignor and the debtor and, in the absence of a choice of law, the law of the country with the closest connection to the original contract. The Working Group decided to avoid including detailed rules as to the law governing the receivable. It was widely felt that such elaborate rules are not necessary in a chapter which is intended to set forth some general rules, without addressing all assignment-related private international law issues. It was also generally thought that it would be inappropriate to attempt to determine the law governing the receivable in the wide variety of contracts that might be at the origin of a receivable (e.g., contracts of sale, insurance contracts, contracts relating to financial markets operations).

105. Inspired by article 12 (2) of the Rome Convention, draft article 28 refers to the relationship between the assignee and the debtor. The assignment does not create a contractual relationship between the assignee and the debtor. The assignor remains the contractual partner of the debtor and

the debtor retains its rights as against the assignor. However, a *de facto* relationship is established between the assignee and the debtor based on the fact that the assignee may notify the debtor and request payment. In order to avoid leaving any doubt, draft article 28 explicitly states that it covers the conditions under which the assignment can be invoked as against the debtor and the debtor's discharge (as to rights of set-off, see A/CN.9/WG.II/WP.104 remarks 1-2 to draft article 28).

106. Draft article 28 also covers assignability as an issue relating to payment by and discharge of the debtor. Whether both contractual and statutory assignability is covered depends on the scope of chapter V, an issue not yet decided by the Working Group. If chapter V applies to transactions falling within the scope of the draft Convention, contractual assignability will be subject to draft article 10, while statutory assignability will be governed by the law specified in draft article 28 under the condition that the forum is in a Contracting State. If, on the other hand, chapter V applies even to transactions falling outside the scope of the draft Convention, contractual assignability with respect to such transactions and statutory assignability with respect to transactions falling both within and outside the scope of the draft Convention will be subject to the law applicable under draft article 28 (in such a case, contractual assignability with respect to transactions falling within the scope of the draft Convention will be subject to draft article 10). The Working Group considered that draft article 28 would govern statutory prohibitions aimed at the protection of the debtor (e.g., restrictions on the assignment of sovereign receivables) or at the protection of the assignor (e.g., restrictions on the assignment of wages, pensions and payments under life insurance policies). The Working Group's considerations were based on the assumption that if the application of the law governing the receivable was contrary to a statutory prohibition contained in a public-policy or mandatory-law rule of the forum and aimed at the protection of the assignor, it could be set aside or even replaced by the mandatory law rule of the forum or another State (see A/CN.9/WG.II/WP.104, remark 3 to draft article 28). The Working Group may wish to reconsider the matter. Statutory prohibitions aimed at the protection of the assignor result in the invalidation of assignments as between the parties thereto and, consequently, as against the debtor. As a result, the issue of the relationship between the assignee and the debtor does not even arise in this context. Thus, it may be more appropriate to subject such statutory prohibitions to the law of the assignor's location than the to law governing the receivable.

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[Article 29. Law applicable to conflicts of priority]

REFERENCES

A/CN.9/445, paras. 70-74

A/CN.9/455, paras. 105-110

COMMENTARY 2/

2/ Depending on the decision of the Working Group as to the scope or purpose of chapter V, draft article 29, which is intended to reproduce the rules contained in draft articles 24 to 26, may be retained or deleted. For this reason, only a brief commentary is provided at this stage.

107. Draft article 29 appears within square brackets pending determination by the Working Group of the scope or purpose of chapter V. Retention of draft article 29 is meaningful only if chapter V is to apply to transactions beyond those falling within the scope of the draft Convention under chapter I. If chapter V has the same scope as the other parts of the draft Convention, draft article 29 repeats rules reflected in draft articles 24 to 26 and may thus be deleted. If retained, draft article 29 would need to be aligned with draft articles 24 to 26 (see A/CN.9/WG.II/WP.104, remarks to draft article 29). If chapter V is to apply irrespective of chapter I, it may need to be specified that it applies also to conflicts involving a subsequent assignment as if the subsequent assignee is the initial assignee (this matter is addressed in chapter I, draft article 2 (b)).

108. As a private international law rule, draft article 29 has the goal of providing certainty with regard to the law applicable to conflicts of priority. Such certainty is dependent upon making reference to the law of a single and easily determinable jurisdiction (the law of the assignor's incorporation or place of central administration; see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5).

109. Priority is defined in draft article 5 (i) as a preference (in payment or other discharge) and draft article 29 specifies the parties between which such conflicts may arise. In view of the fact that the debtor is not one of those parties, priority does not relate to the debtor's discharge. Therefore, the debtor being discharged under the law governing the receivable cannot be asked to pay again the party with priority under the law of the assignor's location.

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Article 30. Mandatory rules

REFERENCES

A/CN.9/455, paras. 111-117

COMMENTARY

110. Paragraph (1) is intended to reflect a generally accepted principle in private international law, according to which mandatory law of the forum may be applied irrespective of the law otherwise applicable. Mandatory law in this context does not refer to law that cannot be derogated from by agreement but to law of fundamental importance, such as consumer-protection law or criminal law (*loi de police*).

111. Paragraph (2) introduces a different rule, namely that a court in a Contracting State may apply neither its own law nor the law applicable under draft articles 27 and 28, but the law of a third country on the grounds that the matters settled in those provisions have a close connection with that country.

112. Departing from the approach followed in private international law texts, the Working Group decided to limit the scope of draft article 30 to the application of the law applicable to the contract of assignment and to the relationship between the assignee and the debtor. It was generally thought that such an approach is warranted with regard to the law applicable to priority issues, since priority rules are of a mandatory nature themselves and setting them aside in favour of the mandatory rules of the

forum or another State would inadvertently result in uncertainty as to the rights of third parties, a result that would have a negative impact on the availability and the cost of credit.

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Article 31. Public policy

REFERENCES

A/CN.9/455, paras. 118-119

COMMENTARY

113. Draft article 31 differs from draft article 30 in that draft article 31 has only a negative effect, i.e. that of setting aside a rule of the applicable law if it is manifestly contrary to the public policy of the forum. Unlike draft article 30, draft article 31 does not have a positive effect, i.e. does not result in the positive application of the public policy of the forum. In other terms, public policy in the context of draft article 31 means international public policy and not the domestic public policy of the forum.

114. In line with the approach followed in other international legal texts, the qualification “manifestly” has been added before the words “contrary to public policy” (see para. 90). It should be noted that it is the application of the applicable law to a particular case and not the applicable law itself which needs to be manifestly contrary to the public policy of the forum. The application of a foreign law, therefore, cannot be refused on the grounds that the law itself, in general, is considered to be inimical to the public order of the forum but only if the application of a particular rule in a concrete case would be repugnant to the public policy of the forum.

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