

UNIDROIT 1997
Study LXXII - Doc. 32 Add. 3
(Original: English)

Unidroit

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP FOR THE PREPARATION OF
UNIFORM RULES ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT

*REVISED DRAFT ARTICLES OF A FUTURE UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT*

(proposed by the Drafting Group in the light of the Study Group's reading at its second session of the first set of draft articles established by the Sub-committee in conjunction with the recommendations of the Aviation Working Group):

COMMENTS

(by Professor C.W. Mooney, Jr. and Mr T. Whalen)

Rome, January 1997

Unidroit

INTERNATIONAL INSTITUTE FOR THE UNIFICATION
OF PRIVATE LAW

PRELIMINARY OBSERVATIONS OF
PROFESSOR CHARLES W. MOONEY, JR. AND MR. THOMAS J. WHALEN,
REPRESENTING THE UNITED STATES OF AMERICA

ON

REVISED DRAFT ARTICLES OF A FUTURE UNIDROIT CONVENTION
ON INTERNATIONAL INTERESTS IN MOBILE EQUIPMENT
(STUDY LXXII - DOC. 30 - ROME, DECEMBER 1996)
(proposed by the Drafting Group in the light of the
Study Group's reading at its second session
of the first set of draft articles established by the
Sub-committee in conjunction with the
recommendations of the Aviation Working Group)

JANUARY, 1997

The United States delegation is pleased to submit to the members of the Study Group and the Unidroit Secretariat its preliminary observations on the revised draft articles (Study LXXII - Doc. 30). We appreciate the efforts made by the Drafting Group, although we realize that much work remains to be done before a workable draft emerges from the Study Group for consideration by governmental experts.

Given the short period between our receipt of the revised draft and the third session of the Study Group, our observations necessarily are preliminary and subject to further input from interested persons and groups in the United States. Moreover, we have omitted from our observations some concerns about the drafting approach and style, which we shall separately communicate to the Drafting Group. Our observations address these concerns only as they relate to specific substantive issues.

1. GENERAL OBSERVATIONS.

Before setting forth our specific observations in the order of the draft articles, we wish offers some general comments and to advance some overarching principles.

a. Recommendations of the Aviation Working Group and the International Air Transport Association.

We support in principle the recommendations of the Aviation Working Group and the International Air Transport Association expressed in Study LXXII - Document 32 (December, 1996). Although we have not yet considered many of the details of the recommendations, we believe that a base convention that contemplates separate protocols for specific classes of equipment is a promising approach. We urge the Study Group and the UNIDROIT Secretariat to give serious consideration to the recommendations.

b. Validity of Interests Created under National Laws.

We are concerned about an apparent omission from the draft. We understood that it was agreed by the Study Group that the effect of the Convention should be to validate interests, not to invalidate interests that currently are valid under applicable law. To that end, the United States delegation understood and reported to its constituencies that the failure to effect an international registration would not render an interest ineffective against attaching creditors and a trustee in bankruptcy if it otherwise would be effective under applicable law. Of course, an (internationally) unregistered interest would remain vulnerable to the rights of buyers and competing registered international interests under the priority rules of Article 25.

As we read Article 26(1), and as we read Article 19(4) of the previous draft (Study LXXII - Doc. 24), it implies strongly that the failure to make an international registration would subordinate the interest to a trustee in bankruptcy. The Convention's priority rules, if adopted by the state whose applicable law otherwise would apply, would override its applicable law.

As we explained in our earlier observations (Study LXXII - Doc. XX), an important advantage of the principle agreed on by the Sub-committee and the Study Group is that it largely solves the most difficult problems of the "purely local" transaction and a "test of internationality." As the Sub-committee struggled with those issues, it discovered that the approaches it considered gave rise to uncertainty, enormous complexity, or both. In a "purely domestic" transaction, where the obligee is confident that the object will never leave the jurisdiction, it may choose to rely on domestic law without worrying that a failure to register internationally will invalidate its interest. This is especially important for domestic transactions that currently are not subject to registration in many systems of local law (such as secured transactions under German law and leasing transactions under United States law). Alternatively, if

the obligee is concerned that its interest may be ineffective under local law, it can ensure effectiveness by making an international registration. We reemphasize that the approach we advocate would not protect an unregistered interest against registered interests and buyers under the priority rules of Article 25 of the revised draft. The intended result could be achieved by adding language to the end of Article 26(1), as follows:

1.- Except as provided by paragraphs 4 and 5, an international interest [or registerable national interest] is valid against the trustee in bankruptcy and creditors of the obligor, including creditors who have obtained an attachment or execution, if prior to the bankruptcy, attachment or execution the international interest was registered in conformity with this Convention or if the interest is valid under applicable law.

Alternatively, the Study Group might wish to add a new paragraph to Article 26 along the following lines:

(x) This Convention does not render invalid as against the trustee in bankruptcy and creditors of the obligor an interest that is valid under applicable law, whether or not the holder of the interest has registered an international interest in conformity with this Convention.

"Applicable law" for these purposes would mean the law applicable by virtue of the rules of private international law.

c. Linkages Between National Registration Systems and the International Registry.

The United States delegation also reiterates its view that the convention should permit contracting states to link their local registries to the international registry so that a registration, recording, or filing under local law will also constitute an international registration. In like fashion, the international registry will be structured so that a search of the registry will uncover locally registered interests that constitute international registrations.

We realize that the registration Working Group has much work ahead and that the revised draft is only illustrative of the rules that ultimately may be included in the convention. However, because the domestic-international linkage approach is so important, we wish to encourage the Study Group to keep it in mind. As with the priority rule advanced above, the linkage approach will be an important factor in attracting support for

the convention in states that have advanced domestic registration systems, such as Canada and the United States. Moreover, the linkages could enhance the awareness and understanding of the international registry.

2. OBSERVATIONS ON SPECIFIC PROVISIONS OF THE REVISED DRAFT

a. Article 1, Paragraph 2

We remain concerned that the inclusion of "true" leases within the Convention's scope might create problems for lessors in some other states. The Study Group may wish to consider alternatives that would not unnecessarily jeopardize a true lessor's residual interest in an object.

b. Article 3

We also reiterate our wish that the Study Group consider a clear directive to a forum court that would apply the Convention as to when it should be applied. The current draft rules remain ambiguous in this respect.

The Study Group may wish to consider the following draft Article 3:

Article 3

1.- This Convention applies if the object of an international interest or obligor is located in a Contracting State.

2.- If the obligor is organized under the law of a State or subdivision of a State and the State or subdivision maintains a public record showing the chargor, buyer, or lessee to have been organized, the chargor, buyer, or lessee shall be deemed to be located in that State. In other cases, the chargor, buyer, or lessee is located in the State where its principal executive office is located.

Under this draft Article 3, by its terms the Convention would not apply when neither the forum court, the object, or the debtor is located in a Contracting State. The Convention also would not apply if the only connection to a Contracting State is the location of the forum court. In all other cases--when either the object or the debtor is located in a Contracting State--the Convention would apply.

c. Article 7, Clause d

Our understanding is that an identification of the obligation secured need not be specific and that language such as "all indebtedness of chargor to chargee of any kind now or hereafter owing" or "payment of the promissory note dated X in the principal amount of Y, together with interest, costs, expenses of collection, attorneys fees and other amounts described therein" would be sufficient.

d. Article 8, Paragraph 6

Note 18 (page 6) of the Secretariat's Introductory Remarks to the revised draft suggest that a surety or guarantor of an obligation secured by an international interest in an object "would not have a legitimate interest requiring protection under the relevant provisions." We submit that a surety does have an interest to be protected because the amount recovered from the object upon default directly affects the amount of the surety's obligation. The Study Group may wish to consider reinstating the protections afforded a surety as an "interested person" under Article 8(6).

e. Article 11, Paragraph 1

We suggest that the Study Group consider whether the reference to a "substantial or persistent default" adequately captures the purpose of paragraph 1. Should a "substantial" default that lasts only a few hours be a default? Should an insignificant breach that is "persistent" be a default? Perhaps a reference to a "material default" would be better.

f. Article 12, Paragraph 3

We believe that paragraph 3 should be revised to make clear that it does not apply to sales or leases undertaken pursuant to judicial proceedings.

g. Article 15

We question whether paragraph 3 is necessary or appropriate, except perhaps with respect to the sale of an object under paragraph 2(e). Preserving the object, its availability, its value, and generally the status quo is a basic protection for a chargee's interest.

h. Chapter VI, Registration of International Interests and Prospective International Interests

The United States delegation intends to provide the Working Group on registration with detailed comments on the proposed registration provisions. We note here only a few general points.

First, we are concerned that the revised draft's return to the concept of a "prospective international interest" adds unnecessary complexity. Any need for this concept arises only from the draft's locution, which embraces the idea that it is the "international interest" that is registered. This confounds the property interest (real rights) received by the chargee with the act of putting a registration statement of record. A registration statement without an interest is a nullity, and the chargor can insist on its removal under Article 18(4). An interest without a registration statement is exposed to subordination. We suggest that the draft adopt the convention of registration (or filing or recording) a registration statement instead of registration of an interest.

Second, we are puzzled by the provisions in Article 17(1) and 19(1), which state that interests "may be registered." We fear that this could be read to permit the registry officials to undertake investigations to determine whether registration is permitted. That approach appears to conflict with the approach envisaged by Article 21(a).

i. Article 25

Paragraph 2

Article 25(2) fails to capture the point that an obligation to give value that is entered into with knowledge of a competing international interest should not count as an obligation for purposes of this priority rule. One approach to this problem would be to revise paragraph 2 along the following lines.

2. - A registered international interest is subordinate to a subsequently registered international interest to the extent that the holder of the first-mentioned interest gives value at a time when the other international interest is registered and the holder of the first-mentioned interest has actual knowledge of the other interest, unless the value is given pursuant to an obligation entered into without actual knowledge of the other interest.

There is another problem with paragraph 2. Consider the following hypothetical. Chargee 1 registers its interest and advances £100. Chargee 2 subsequently registers its interest and advances £100. With actual knowledge of Chargee 2's interest, Chargee 1 advances £50. Under paragraph 2, Chargee 1's interest is subordinate to Chargee 2's interest to the extent of Chargee 1's £50 advance. Now suppose that Chargee 2, with actual knowledge of Chargee 1's interest, advances £50. As written, paragraph 2 would seem to subordinate Chargee 1's interest to that of Chargee 2's, even with respect to Chargee 2's subsequent £50 advance. In short, the subordination rule should work against any Chargee that advances funds with actual knowledge of another interest unless made pursuant to an obligation. The following revised paragraph 2 would address this problem.

2. - A registered international interest is subordinate to another registered international interest to the extent that the holder of the first-mentioned interest gives value at a time when the other international interest is registered and the holder of the first-mentioned interest has actual knowledge of the other interest, unless the value is given pursuant to an obligation entered into without actual knowledge of the other interest.

Paragraph 4

We note two problems with paragraph 4. First, as we explained in our earlier observations, the special priority rule contained in paragraph 2, when applied with paragraph 4, creates the possibility of circular priorities. Consider a first-registered Chargee 1 and a second-registered Chargee 2. After Chargee 1's interest is registered but before Chargee 2's interest is registered, a non-international interest arises in favor of I. Then, Chargee 1 makes a non-obligatory £50 advance with actual knowledge of both Chargee 2's and I's interest. Under the revised draft, as to the £50 advance, Chargee 1's interest has priority over I's interest under paragraph 4, I's interest has priority over Chargee 2's interest under paragraph 4, and Chargee 2's interest has priority over Chargee 1's interest under paragraph 2. To avoid this problem, the Study Group may wish to consider an exception to the priority rule in

paragraph 3 similar to the one in paragraph 1. Stated otherwise, the holder of an interest other than an international interest also might be granted seniority over an earlier-registered international interest to the extent that the holder of the international interest makes discretionary advances with knowledge of the other interest.

Second, paragraph 4 applies to interests other than international interests, including both ownership interests and liens or other charges that secure obligations. Although subordination of an unregistered international interest to a competing lien or charge is an appropriate means of protecting the claimant against the unregistered interest, it seems inappropriate for the case of a buyer of an ownership interest. The latter should take free of the unregistered international interest. Perhaps separate paragraphs for buyers and those holding liens or charges would be appropriate.

j. Article 26, Paragraph 5

Article 26(5) preserves the effectiveness of any "special rules of insolvency law." Given the enormous diversity of national insolvency laws, the Study Group may wish to consider whether an effort should be made to clarify in the draft the nature of the "special rules" that are to be preserved. Following these observations are (i) a proposal made by the United States delegation to the UNCITRAL Working group on International Contract Practices in connection with its Receivables Financing project, and (ii) draft revisions to Article 21 of the articles of a draft convention on assignment in receivables financing, which reflect the delegation's proposals. The Study Group may wish to consider these proposals in connection with Article 26(5). Alternatively, the Study Group may wish to consider additional rules in the convention that would override certain national insolvency rules. For example, international interests registered more than X months before the commencement of a chargor's insolvency proceeding might be protected from invalidation as preferences.

k. Article 28, Paragraph 3

We are unclear as to the goal and rationale of Article 28(3). Many of the most common and significant financial arrangements involve carving up receivables of one sort or another and assigning them to multiple assignees. Transactions run from straightforward bank loan participations to sophisticated securitizations. Article 28(3) could be read to prevent such assignments in the case of receivables secured by an international interest. If the goal is merely to provide that there can be no more than one assignee/chargee of record at any time, then a more narrow provision for that could be made.

l. Article 29

We suggest that this article (or another appropriate provision of Chapter VIII) be revised to make clear that the valid assignment of an international interest carries with it, automatically, the valid assignment of the obligation secured by the international interest (i.e., the receivable owed by the chargor to the assignor-chargee). This result is implicit in Article 31, but does not appear to be stated affirmatively in the draft.

m. Article 32, Paragraph 1

We suggest that paragraph 1 be revised to make clear that, on default, the assignee is entitled to collect from the chargor amounts owed on the obligation secured by the object, subject to Article 31.

n. Article 33

We are unsure as to the reason for the parenthetical in Article 33, which excepts Article 25(2).

FOR PARTICIPANTS ONLY

A/CN.9/WG.II/XXVI/CRP.3
18 November 1996

ORIGINAL: ENGLISH

UNITED NATIONS COMMISSION ON
INTERNATIONAL TRADE LAW
Working Group on
International Contract Practices
Twenty-sixth session
Vienna, 11 - 22 November 1996

RECEIVABLES FINANCING

Proposal by the United States of America

Insolvency-related issues

As you know, articles 21 through 24 of WP.89 deal with rights of creditors and the bankruptcy administrator of an assignor against an assignee with respect to the assigned receivables. We recognize that this subject matter raises some very difficult issues, especially because of the lack of uniformity of national laws relating to creditors' rights and insolvency. To assist the Working Group to address these issues, we raise the following questions for the consideration of the Working Group.

Anti-discrimination. One question is whether there should be a general rule that an assignee under the Convention should be treated no less favorably than a similarly situated assignee under national domestic law would be treated. For example, if an assignee which has complied with provisions of national domestic law to obtain priority over attaching creditors or an insolvency administrator would be treated in a certain way under national domestic law, then should not an assignee which has complied with the provisions of the Convention to achieve that same priority be treated at least as favorably? Our view is that this should be the case. Such a rule of non-discrimination in national treatment would establish a minimum safeguard for assignees under the Convention.

Fraudulent transfers. A second question is whether, as currently set forth in WP.89, the Convention should defer to national laws on transfers that are fraudulent under national laws. We would think so.

Certain substantive insolvency rules. We also ask whether the Convention should defer to national insolvency laws relevant to the following issues:

- (a) Whether an assignment may be set aside as preferential (as currently set forth in WP.89),
- (b) Whether an assignment of receivables that do not exist at the commencement of the insolvency may be invalidated by the insolvency administrator, and
- (c) Whether an assignment of receivables that exist but are unperformed or only partially performed at the commencement of the insolvency may be charged with the expenses of the insolvency administrator in performing those receivables for the benefit of the assignee.

Certain procedural insolvency rules. We ask, as well, whether, at least in the case where the assigned receivables are security for indebtedness or other obligations, the Convention should defer to national insolvency laws relevant to the following issues:

- (a) Whether assignees and creditors are stayed in the insolvency from collecting, applying or enforcing their security,
- (b) Whether the insolvency administrator may use the assigned receivables to operate the insolvency estate if the insolvency administrator provides replacement security to the assignee,
- (c) Whether the insolvency administrator may borrow against the assigned receivables to the extent that the value of the assigned receivables exceeds the obligations secured, and
- (d) Whether the assigned receivables may be charged by the insolvency administrator with privileged claims (such as taxes and wages). If the Working Group were to decide that the assigned receivables may be charged with privileged claims, the Working Group may also wish to consider another anti-discrimination principle: that the assignee's security would have to be charged fairly and equitably with other security that may also be charged with privileged claims.

Other insolvency rules and procedures. We raise the question whether there are other insolvency rules and procedures of similar effect to which the Convention should defer.

* * *

SELECTED INSOLVENCY RELATED PROVISIONS

Article 21. Rights of third parties

(1) Except as provided in this article 21 and articles 22 to 24, this Convention does not affect the rights of the assignees receiving the same receivables from the assignor, the assignor's creditors attaching the assigned receivables or the assignor's creditors in the context of the insolvency of the assignor.

The balance of article 21 is largely new.

(2) Notwithstanding articles 22 to 24, and except as provided in paragraph (3), this Convention does not govern:

(a) any right of creditors of the assignor attaching the assigned receivables to contest or invalidate the assignment as a fraudulent transfer.

(b) any right of the administrator in the insolvency of the assignor:

(i) to contest or invalidate the assignment as a fraudulent or preferential transfer,

(ii) to contest or invalidate the assignment of receivables that do not exist at the time of the commencement of the insolvency of the assignor,

(iii) to charge the receivables with the expenses of the administrator in performing any receivables that do exist but have not been earned by performance at the time of the commencement of the insolvency of the assignor, or

(iv) to charge the receivables with the expenses of the administrator in maintaining, preserving or enforcing the receivables at the request and for the benefit of the assignee, or

(c) with respect to any receivables assigned by the assignor by way of security for the performance of an obligation, any insolvency rules or procedures, generally governing the insolvency of the assignor apart from this Convention:

(i) staying the collection, application or enforcement of the receivables during the insolvency,

(ii) permitting substitution of the assigned receivables for new receivables of at least equal value,

(iii) permitting other assignments of the assigned receivables without prejudice to the position of the assignee,

(iv) permitting assigned receivables to be charged with privileged claims for taxes, wages and similar privileges so long as the assignee is treated fairly and equitably with other creditors whose security may be so charged, or

(v) other rules and procedures of similar effect and of general application in the insolvency of the assignor [**specifically described by a Contracting State in the instrument providing for its ratification of this Convention**].

(3) The rights of an assignee entitled to priority in the assigned receivables under paragraph (a) of article 23 or 24 may not be prejudiced in relation to the rights of another party receiving an assignment from the assignor in the same receivables and who would be entitled to priority under paragraph (b) of article 23 or 24, whether or not such other party actually exists.