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United Nations Commission on International Trade Law

Resumed fortieth session

Summary record of the 861st meeting
Held at the Vienna International Centre, Vienna, on Thursday, 13 December 2007, at 9.30 a.m

Chairperson: Ms. Sabo (Vice-Chairperson) (Canada)

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The meeting was called to order at 9.40 a.m.

Adoption of a draft UNCITRAL Legislative Guide on Secured Transactions and possible future work (A/CN.9/617, 620, 631 and Add. 1-11, and 637 and Add.1-8; A/CN.9/XL/CRP.10 and 11 and Add.1) (*continued*)

Recommendation 205: Proposal by the observer for the European Commission (continued)

1. **The Chairperson** invited the Commission to resume its consideration of the proposal made by the observer for the European Commission.

2. **Ms. Perkins** (United Kingdom) said that her delegation had grave concerns about the current wording of recommendation 205 because it went a great deal further than the European Union's proposed regulation on the law applicable to contractual arrangements (Rome I). Recommendation 205 provided that the law applicable to the creation of a security right was the law of the State in which the grantor was located. In her view, that matter had been settled under European Community law in the 1980 Rome Convention on the law applicable to contractual obligations.

3. Her delegation had consistently voiced its concern about the recommendation's implications for financial contracts that had not been excluded from the scope of the draft Guide, financial contracts that were not governed by netting agreements, spot trading and some forward trading of commodities, and the assignment of positions under such trading. Moreover, some over-the-counter equity derivatives and bond options might not be backed up by netting agreements, for instance because they were old agreements, because there had been an oversight or due to pressures of fast trading. There was also no indication that receivables arising from insurance contracts had been excluded from the scope of the draft Guide. As the beneficiaries of insurance policies might be natural persons, ships or mobile businesses, it was extremely common for the grantor's location to change frequently. Recommendation 205 was not an appropriate conflict-of-law rule either for securitization transactions, residential or commercial mortgage-backed securities, collateralized debt obligations (CDOs), collateralized bond obligations (CBOs) and collateralized loan obligations (CLOs).

4. While her delegation appreciated the important role of recommendation 205 with respect to certain financial practices, it had a number of proposals for additional wording that would create a measure of flexibility for jurisdictions that wished to apply a different conflict-of-law rule to the key markets and industries that she had mentioned. One option discussed in informal consultations with other delegations was to provide for two alternatives, A and B, so that States could either apply recommendation 205 as currently worded or apply it as the basic rule with a carve-out for cases where the underlying intangible asset was created by a contract. If that solution was considered to be too radical, her delegation was prepared to propose instead that the word "ordinarily" should be inserted in the opening phrase of recommendation 205, which would then read: "The law should ordinarily provide that …". The commentary would then explain that some key financial markets and medium-level financing practices were not adequately served by the rule laid down in recommendation 205.

5. **Ms. Gibbons** (United Kingdom) said that she was both an adviser to the British Government and a partner in a law firm with responsibility, inter alia, for framing legal opinions regarding securitization transactions.

6. Noting that certainty was one of the key objectives of the draft Guide, she said that if a rule such as that in recommendation 205 were to be applied without any provision for derogation, it would undermine certainty in the securitization market. A key feature of securitization transactions, which were now an international phenomenon and by no means confined to the London-based market, was that rating agencies required a measure of certainty, which was achieved through an assessment of the commercial risks involved in the transaction and through legal opinions.

7. For example, an originator whose "centre of main interest" under the European Community Regulation on Insolvency Proceedings was in France might also enter into contracts with grantors in Germany and Spain. The benefit of those contracts might be assigned by the originating company in the form of an outright transfer to a special purpose vehicle, which in turn might assign its interest in the contracts to a security trustee. Both assignments would be covered by the

terms of the draft Guide. Under current practice, the assignments would be governed by the law of the underlying contract, in other words by French law. Under recommendation 205, however, it would be necessary to determine the current location of the grantor, which was not always clear. Many businesses had branches in a large number of different countries and a grantor's place of residence could change. Each time an originator made further issuances, new legal opinions would become necessary to establish its location and it would be extremely difficult to present rating agencies with a reliable assessment of the legal risks involved.

8. **Mr. Deschamps** (Canada) noted that securitization had frequently been cited some years previously as a branch that benefited from the assignor location rule under the United Nations Convention on the Assignment of Receivables in International Trade (United Nations Assignment Convention). His company had recently been consulted by an international law firm about a securitization transaction involving an originator with its centre of main interest in France and with customers in some ten other countries, including Canada. The firm's lawyer had commented that it was unfortunate that France did not apply the same conflict-of-law rule as Canada, namely the assignor location rule.

9. **Mr. Umarji** (India) said that in the event of default and enforcement of a loan, the grantor could not be required to move from one jurisdiction to another in response to actions for recovery. The grantor's interests should also be protected. He was therefore opposed to any amendment of recommendation 205.

10. **Mr. Smith** (United States of America) expressed support for the views expressed by the previous two speakers. Securitization transactions were commonly undertaken in jurisdictions that applied the conflict-of-law rule set out in recommendation 205 without entailing any systemic risk or trouble with rating agencies. No rule was perfect, but the Commission had concluded after lengthy deliberations that, on balance, the rule contained in recommendation 205 was the best available. It would work, for example, in situations where financing was sought against a pool of receivables involving contracts that were governed by the laws of a number of different countries. He was aware that the "centre of main interest" criterion had given rise to litigation in Europe, but the problems addressed in the cases concerned were relatively unusual. In most transactions it was quite clear where the grantor was located and the financing documents would normally restrict the grantor's freedom to change location. He strongly supported recommendation 205 because it ensured certainty and low transaction cost, furthered the purposes of the draft Guide and was consistent with the United Nations Assignment Convention.

11. **Mr. Schöfisch** (Germany) said that the purpose of the draft Guide was to give advice to States and to provide them with information. Unfortunately, recommendation 205 omitted relevant information by failing to mention that some States had opted for different approaches, which could be explained in the commentary. The concerns described by the delegation of the United Kingdom underscored the usefulness of such a clarification, which should be couched in neutral terms in the text of the recommendation.

12. **Mr. Kalns** (Latvia) expressed support for the proposal by the representative of Germany.

13. **The Chairperson** pointed out that the purpose of the recommendation was to present the Commission's decision regarding what it considered to be the best solution and that of the commentary was to present the different options. Working Group VI (Security Interests) and the Commission had discussed the issues raised by the delegation of the United Kingdom at length and had taken a decision in full knowledge of the implications of the rule in recommendation 205. As already noted, the matter had also been discussed in the context of the negotiations on the United Nations Assignment Convention. The Commission could not now reverse its decisions in those two cases.

14. **Mr. Porreca** (Italy) expressed support for the comments and proposals made by the delegation of the United Kingdom. Although the Commission had already adopted a decision, he saw no reason why it should not show some flexibility in such a complex matter in order to accommodate all concerns. Its main aim should be to promote the widest possible utilization of the draft Guide by legislators.

15. **Mr. Kohn** (Observer for the Commercial Finance Association) said that one of the goals of the draft Guide was to minimize transaction costs, which could make financing prohibitively expensive. As such costs were particularly high in the case of securitization transactions, the rule in recommendation 205 would make it easier for many companies to obtain access to secured credit. He submitted that in the vast majority of situations, it was easy to determine the location of the grantor. On the other hand, where the pool of receivables involved customers in many jurisdictions, the process of determining the applicable law could be time-consuming. In many cases, there was no express choice of law in the documents generating the

receivable, and considerable due diligence was required to determine which law was applicable and what the law stipulated regarding the creation, effectiveness and priority of a security right.

16. **Mr. Markus** (Switzerland) said that he agreed with the Chairperson that it would be inappropriate to change the Commission's decision regarding recommendation 205. On the other hand, as serious concerns had been raised, he proposed showing some flexibility in the commentary by outlining options that could be viewed as the second best approach. Moreover, to promote legal certainty regarding possible changes in the location of the grantor, he proposed referring in the commentary to the possibility of establishing a point in time that would be decisive for the purpose of determining the grantor's location.

17. **Mr. Voulgaris** (Greece) and **Mr. Riffard** (France) expressed support for the proposal by the representative of Switzerland.

18. **Ms. Kaller** (Austria), **Ms. Kolibabska** (Poland), **Ms. Gavrilescu** (Observer for Romania) and **Mr. Urminský** (Observer for Slovakia) expressed support for the position stated by the delegation of the United Kingdom and also for previous speakers who had called for flexibility so that as many jurisdictions as possible could apply the draft Guide.

19. **Mr. Bazinas** (Secretariat) said that the commentary, as it stood, sought to reflect the different approaches adopted in different jurisdictions and could be expanded if the Commission so desired.

20. He pointed out that conventions prepared by UNCITRAL were draft conventions that were submitted for adoption by diplomatic conferences or the General Assembly. Once an instrument had been adopted by either of those bodies, it could be amended only in accordance with the rule laid down in the text. Under the United Nations Assignment Convention, one third of the Contracting States could request the holding of a diplomatic conference to revise or amend the Convention. The Commission, as a subsidiary body of the General Assembly, could not circumvent the amendment or revision process by introducing a change of policy through a model law, guide or recommendation.

21. According to practitioners in many parts of the world, the advantages of the rule laid down in recommendation 205 were mainly felt in the context of receivables financing. Where there was a bulk assignment of receivables, a key concern was the insolvency of the assignor. That consideration had strongly influenced the decision by the Commission and the General Assembly to recommend that the applicable law should be the law of the most likely location of the main insolvency proceedings with respect to the assignor, grantor or borrower, thus ensuring that the same law would govern priority and the ranking of claims in insolvency proceedings.

22. **The Chairperson** said that it was important to try to resolve all concerns within the constraints under which the Commission was operating. However, she had been present during the negotiation of the United Nations Assignment Convention and at the drafting sessions of Working Group VI on the draft Guide and she had heard no new arguments at the present meeting on either side. Although certain financial practices had become more prominent in recent years, the fundamental reasoning that had led to the policy decisions remained unchanged. In that context, she invited the Commission to consider how the helpful proposal by the delegation of Switzerland might be reflected in the commentary.

23. **Mr. Wezenbeek** (Observer for the European Commission) said that the European Commission had been requested to undertake an impact assessment on the issue under discussion and to report its findings to the European Council in two years' time. The member States of the European Union had discussed chapter XII of the draft Guide and concluded that it should be placed on hold. However, he felt that such a request to the Commission would be inappropriate and would fail to do justice to the fine work it had accomplished to date. Nevertheless, sections of industry throughout the European Union were dissatisfied with the rule laid down in recommendation 205 and only one member State had signed the United Nations Assignment Convention. It would therefore be unfortunate if there was no possibility of considering a minor amendment to the recommendation, such as inserting the word "ordinarily", as proposed by the delegation of the United Kingdom, and then expanding the commentary to explain other practices.

24. **Ms. McCreath** (United Kingdom) said that her delegation did not view its proposal as a formal amendment but rather as a pointer to other practices. She noted that the draft Guide expanded on the definition of a financial contract in the United Nations Assignment Convention in order to clarify what normally occurred in financial markets.

25. **Ms. Gibbons** (United Kingdom) said that in the securitization industry it was necessary in all cases involving several grantors of significant size in different jurisdictions to examine the enforceability of

contracts in the grantors' local jurisdictions in order to inform rating agencies of the risks involved. The rule laid down in recommendation 205 did not detract from the need to be aware of the rules governing grantors by virtue of the contracts into which they had entered with the originator and the jurisdiction in which they were located. It simply introduced an additional jurisdiction to investigate. Moreover, it was not always easy to determine and deliver a legal opinion on where a company's centre of main interest was located. The due diligence involved might in fact prove quite costly.

26. **Ms. Perkins** (United Kingdom) said that the commentary failed to address her delegation's concerns regarding the applicable law, since it referred to the law of the grantor's residence and the *lex situs* of the intangible asset but not to the law in the contract that created the intangible asset, in other words the law of the receivable.

27. She wondered whether the creation of security rights in shipping insurance contracts had been discussed when the United Nations Assignment Convention was being negotiated. The common practice of repeatedly assigning an insurance policy relating to a ship and its contents had given rise to a substantial amount of case law on the subject in the United Kingdom. She had been informed by English judges that the rule contained in recommendation 205 was not applicable to such cases.

28. There was clearly no consensus in the Commission that one rule could be identified as the best for all States in every circumstance. While one rule was certainly the best for a wide range of financial situations, a different rule might be more appropriate for other kinds of secured transactions. She submitted that her delegation's proposal to add a single word to the recommendation and to explain different options in the commentary was not excessive.

29. **Mr. Deschamps** (Canada) said that his delegation agreed that the commentary should be more detailed and expand on the various alternatives, presenting the law governing the receivable as an alternative to the *lex situs*.

30. With regard to recommendation 205, the delegation of the United Kingdom had proposed excluding cases where the underlying intangible asset was created by a contract or, if that was too radical, inserting the word "ordinarily" in the opening phrase. If intangible assets arising from contracts were excluded, however, recommendation 205 might as well be omitted from the draft Guide because financial contracts, securities and other items were already excluded. He urged delegations that were in favour of replacing the grantor's location rule by a rule based on the law governing the receivable to compare the advantages and disadvantages of the two rules not only with regard to an assignment of a specific receivable but also with regard to a bulk assignment, especially one including future receivables. If the priority of the assignee with respect to future receivables was unknown, as it might well be if a rule based on the law governing the receivable was adopted, it would be difficult to provide sound advice to a rating agency.

31. The word "ordinarily" was too vague to be included in the recommendation itself but it could be inserted in the commentary, which might state, for instance, that the general rule proposed in the recommendation would ordinarily be applicable to situations involving trade receivables.

32. **Mr. Umarji** (India) said that it was debatable whether the draft Guide covered marine insurance policies relating to ships and the receivables under such policies. In any case, assignments in that context would constitute a very limited area in terms of the scope of the draft Guide.

33. **Mr. Smith** (United States of America) expressed support for the comments by the representative of Canada. However, he had reservations about the use of the word "ordinarily" in the commentary because it would be undesirable, for instance, to apply one conflict-of-law rule to a loan and another to a related securitization transaction. A single conflict-of-law rule was essential in order to determine priority.

34. A rule based on the law governing the receivable would be inconsistent with the draft Guide's aim of encouraging countries with emerging economies to improve their secured transactions law. Developed countries were enacting sophisticated laws to accommodate securitization transactions and anyone entering into a commercial transaction would clearly wish to have it governed by such a law rather than by the law of a developing country.

35. **The Chairperson** said she took it that, in view of the strong objections that had been raised to any reopening of the debate on recommendation 205, the Commission agreed to address the concerns expressed by a number of its members in the commentary.

36. *It was so decided*.

37. **Ms. McCreath** (United Kingdom) requested that the official record of the session reflect her delegation's position that recommendation 205 was not the best rule and its concern about the rule's possible adverse impact on the industries mentioned in its earlier statements.

The meeting was suspended at 11.35 a.m. and resumed at 12.05 p.m.

38. **Mr. Smith** (United States of America) read out the following paragraph, which he described as a starting point for further elaboration of the commentary:

> "Some countries have a different conflict-of-law rule for intangibles from the rule in recommendation 205. Those countries contemplate capital market or other transactions, which seek perhaps greater certainty established by looking not to the law of the grantor's location, but rather to the law governing the intangible. The rule that looks to the law governing the intangible has the advantages of avoiding the risk of a subsequent change of location of the grantor and a single, stable conflict-of-law rule for transactions involving successive assignments of the intangibles among assignors located in different countries. It is not as advantageous for the assignment of intangibles in bulk that may be governed by the laws of multiple countries. Moreover, it shifts the risk of a change of location of the grantor to the risk of a change in the law governing the intangible."

39. **Mr. Wezenbeek** (Observer for the European Commission) said that the representatives of member States of the European Union attending the session very much regretted the decision not to reopen the debate on recommendation 205 notwithstanding the considerable support that had been expressed for the proposal by the delegation of the United Kingdom to insert the word "ordinarily" in the opening phrase of the recommendation. They requested that their position should be reflected in the record.

40. The preliminary response of the same delegations to the text proposed by the representative of the United States was that the last two sentences were not sufficiently factual and should be deleted.

41. **The Chairperson** pointed out that, in the view of a number of delegations of member States of the Commission, the insertion of the word "ordinarily" in the recommendation would have amounted to a substantive amendment to a text that had already been adopted by the Commission.

42. **Mr. Burman** (United States of America) suggested that the record should also reflect the fact that other delegations had withdrawn a number of proposed amendments regarding substantive matters that they considered to be important.

43. **Mr. Schöfisch** (Germany), welcoming the proposal to expand the commentary to reflect different options, expressed a preference for a neutral approach that would refrain from stating that one option was better than another.

44. **The Chairperson** said that the Commission had been careful in the draft Guide to ensure that the commentary covered all options but at the same time explained why a particular option was being recommended. On the other hand, where alternatives were offered, as in the recommendations regarding the unitary and non-unitary approaches, it had adopted a more neutral and balanced approach.

45. She took it that the Commission wished to give a mandate to the Secretariat to reflect the discussion that had taken place at the meeting as well as the content of the proposal by the delegation of the United States in the commentary.

46. *It was so decided.*

Revised commentary to chapter VII: Priority of a security right (A/CN.9/637/Add.1)

47. **The Chairperson**, noting that the Commission had approved the substance of the original commentary to chapter VII during the first part of the session, asked whether members had any comments on the revised version.

48. **Ms. Walsh** (Canada) proposed clarifying that the rules on priorities were designed to deal with competing rights of claimants all of which were derived from the same grantor.

49. She further proposed making a clearer distinction between third-party effectiveness issues and priority issues and, in general, avoiding repetition in the commentary.

50. *The substance of the revised commentary was approved subject to those amendments and any necessary editorial modifications.*

Revised commentaries to chapter VIII: Rights and obligations of the parties; chapter IX: Rights and obligations of third-party obligors; chapter X: Enforcement of a security right; and chapter XI: Acquisition financing (A/CN.9/637/Add.7 - 5)

51. **The Chairperson** noted that the Commission had approved the substance of the original versions of the commentaries to chapters VIII to XI during the first part of the session. It had also decided earlier in the resumed session to reflect the changes to the recommendations under chapter XI in the commentary.

52. *The substance of the revised commentaries was approved subject to any necessary editorial modifications*.

Revised commentary to chapter XII: Conflict of laws (A/CN.9/637/Add.6)

53. **The Chairperson** noted that the Commission had approved the substance of the original commentary to chapter XII at the first part of the session.

54. **Ms. Perkins** (United Kingdom) said that the revised commentary failed to explain the interrelationship between recommendations 45, 205 and 217. Uncertainty arose where an assignor changed location and different priority rules were applicable under the laws of the first and second location. Under recommendation 217, the law of the new location would govern third-party effectiveness and priority, but that rule would leave the first assignee unduly exposed. Under recommendation 45, however, the assignee was given a brief period during which it could close its exposure window by making its security right effective against parties under the law of the assignor's new location. The procedure for remedying uncertainty was thus somewhat tortuous. Moreover, recommendation 45 might not be applicable in the forum State.

55. **The Chairperson** said she took it that the commentary should explain the interaction between recommendations 45, 205 and 217, in particular with a view to explaining how the problem of a change in the grantor's location was addressed under the draft Guide.

56. *The substance of the revised commentary was approved subject to that decision and any necessary editorial modifications*.

The meeting rose at 12.35 p.m.