

Cross-border receivables financing: What law governs?

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Receivables financing takes many forms: traditional factoring; loans secured by receivables; and, at the most complex level, securitisation of receivables in the capital markets. In all these cases, the business premise is the same: the financial markets are more (or only) receptive to accepting the credit of the party owing payment on the account. In this way the “account debtor”, to use US terminology, effectively makes its credit available to its trade customers, as financial institutions often do in different trade finance settings. In many cases, the finance provider will wish to eliminate the credit risk of the assignor - and perhaps its country risk as well - from the transaction entirely.

In the US, the revision of Article 9 of the Uniform Commercial Code (UCC), which became effective in New York in 2001, improved the legal underpinnings of receivables financing and removed some important uncertainties that had arisen in the area. Following this development, the UNCITRAL Convention on the Assignment of Receivables in International Trade (the Convention) was completed in December 2001, and the US signed the Convention in December 2003. The Convention draws heavily on Revised Article 9. In both, choice of law provisions received particular attention.

The effort to unify law and practice for the financing of accounts is a challenging one, because there are a minimum of three parties involved and the law is far from uniform. Even when the framework for establishing a proper assignment is established, a financier will require assurance that it will have priority over other claimants and that the transfer will be recognised in insolvency. It will also need to know that the rights of the account debtor have been ascertained and taken into account.

The drafters of the Convention were unable to reach consensus on substantive rules to cover all the major points, and instead relied on choice of law rules to promote predictability. It is an interim step, which future developments will no doubt build on.

Revised Article 9 focused particularly on accounts. On a substantive level, the revisions broadened the definition of “account” to increase the range of financeable assets; broadly invalidated restrictions on transfer that could invalidate or impede transfers in financing transactions; and provided specifically that a “true” sale of an account, i.e. one with essentially no recourse back to the transferor, should be recognised as such even if (as is customary) the sale is perfected under the UCC in the same way as is a security interest.

The revisions also altered and simplified the mode of perfection of security interests: a financing statement, which is a simple notice filing providing essentially an identification of the debtor (i.e., the transferor or assignor of the account), and a description of the collateral, must be filed in one place - where the debtor is “located”. In Revised Article 9, for corporations and other “registered organisations”, that place is its jurisdiction of organisation. The specification of the place of filing is often considered a choice of law rule. This is, however, debatable: it is more a geographic pointer for where action that determines perfection must be taken.

Perfection to US lawyers means action that will enable the creditor to defeat a judicial lien creditor or bankruptcy trustee¹. Priority is a broader concept but just as vital. A party that files a financing statement after one has already been filed on the same collateral is perfected, but can still lose all of its collateral due to its lower priority - it has rights only to any surplus.

In the international context, imagine a claim by a creditor in one jurisdiction that it has a valid claim (whether a transfer or a security interest) to an account because it has notified the account debtor, which is the proper mode of perfection in the creditor’s jurisdiction. However, another creditor has filed a financing statement in a jurisdiction that allows for filing a notice statement as a method of perfecting a transfer of accounts. Both creditors are perfected, but only under their own jurisdiction’s law. Representations obtained in the financing documents and contractual choice of law clauses are of limited use here; many statutory rules in secured transactions and insolvency operate in a mandatory, and forum-centered, fashion. Who, then, prevails? And which jurisdiction’s law determines who prevails?

The creditor which, at the inception of the transaction, accurately predicts all of the possible jurisdictions, and perfects in each of them is of course the leading candidate for success. This is always the optimal solution in cross-border transactions of all types. However, it is sometimes expensive to perfect in multiple jurisdictions, and always expensive to obtain multiple legal opinions supporting perfection. The US enthusiasm for notice filings is not shared elsewhere; sometimes assignors and account debtors resist the filing of financing statements (although there are ways of accommodating that concern). The situs of insolvency proceedings is inherently impossible to predict with certainty.

Notification as a method of perfection against non-US debtors has been rejected in Revised Article 9². The drafters of the Convention had high hopes of establishing perfection by filing in a new international filing system based on the UCC model as the method of choice. Instead, they settled for a series of choice of law rules, together with an "opt-in" schedule to the Convention text providing for a choice of substantive perfection rules (of which

such filing is one).

Under the Convention³, perfection and priority of an assignment, and the nature of the assignee's interest, are determined by the internal law of the assignor's location. Furthermore, such "location" is determined in pre-Revised Article 9 fashion, i.e. according to where the assignor's place of business is located. If there is more than one place of business, this location is where the central administration is exercised⁴. Prospective account purchasers will observe that this rule points to their customers' jurisdiction, which may not be their first choice for this critical area.

There are other conflicts rules in the Convention covering particular issues regarding, for example, the formal validity of an assignment, the mutual rights and obligations of assignor and assignee, and the relationship between assignee and (account) debtor. These rules are stated to apply in the courts of Contracting States even if the receivable assignment in question is not covered by the Convention (e.g., because it is not "international", as that term is defined).⁵ Generally, in order for the Convention to apply, either the assignor and assignee must be in

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different States, or the assignor and the (account) debtor must be in different States.

The Convention will represent an advance in substantive law in many jurisdictions. For instance, it specifically validates bulk assignments of receivables⁶ and of future receivables.⁷ These rules may not fully supplant local law on all relevant issues; for instance, New York banks do not have the power to purchase receivables generated by goods not yet sold or services not yet rendered.⁸ Like Revised Article 9, the Convention invalidates many contractual transfer restrictions.⁹

This is obviously not a complete description of the Convention. It has not been particularly successful in attracting signatories so far, and it is therefore far from becoming the global framework for cross-border receivables transactions its drafters envisioned. Yet it will probably be the basis for further efforts in legal harmonisation and thus deserves study.

Hopefully, the requirements of global trade will engender demand for increased clarity in the laws of finance and of insolvency, and in country risk mitigation techniques. Financial institutions and their customers on the lookout for innovative financing techniques will no doubt provide the main impetus.

Notes

- ¹ UCC 9-102(a)(52).
- ² One of the confusions in pre-Revision Article 9 was that notification was a secondary method of perfecting against non-U.S. debtors, but the provision was drafted as a choice of law rule!
- ³ Article 22, 30.
- ⁴ Article 5(h).
- ⁵ Chapter V.
- ⁶ Article 8(l).
- ⁷ Article 8(1)(b).
- ⁸ New York Banking Law Section 96(1).
- ⁹ Article 9(l).

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