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R E P O R T

on the

CONTRACT OF FACTORING

prepared by the Secretariat

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INTRODUCTION

At its 53rd session (February 1974), the Governing Council was seized of a proposal by the Secretariat for the elaboration of uniform rules governing either the general problem of the assignment of debts or the more specific problem of the contract of factoring (C.D. 53, Doc. 3, UNIDROIT 1974, page 36) and at its 54th session (April 1975) it instructed the Secretariat to make a detailed study of the subject on the basis of a Memorandum which the latter had presented to it "Supplementary memorandum prepared by the Secretariat on the contract of factoring" (C.D. 53, Doc. 3 Add. 1, UNIDROIT 1974).

The present report on factoring is divided into three parts dealing with factoring operations in practice, factoring and national legislation and problems peculiar to international factoring.

PART I : FACTORING OPERATIONS IN PRACTICE

Preliminary remarks

1. Broadly speaking factoring may be described as the transfer by the creditor or supplier - client in common law terminology - of short term book debts to a specialised company or factor who guarantees their recovery from the debtor or buyer - known in common law as the customer - even in the event of default by the latter, against payment.

2. Historically, factoring⁽¹⁾ first appeared in the seventeenth century when the Pilgrim Fathers, British settlers who had emigrated to North America, commissioned agents referred to in the contracts of the time as "agents and factors", to sell in Great Britain furs, fish and wood which they would send there. These factors stored the goods and sold them in their own name to buyers of their choice, guaranteeing payment of the purchase price to the supplier. They sometimes even agreed to advance money on the goods before the sale took place.

During the nineteenth century the practice fell out of use in Great Britain whereas in the United States, on the contrary, it became very widely used as a result of the capacity of American factors to adapt themselves to new situations. Their activity, which had hitherto consisted in the sale of textiles imported from Europe - that is in international transactions - came up against protectionist barriers erected by local textile producers and they decided to offer their services - which had become of an essentially financial nature - to American producers both in the textile industry and in other sectors, instead of to European exporters. This was the beginning of modern factoring which was only introduced into Europe in the nineteen-sixties.

3. From a legal point of view factoring creates a direct relationship between two people : the factor and the supplier. However, there are other persons who, without having contracted formal undertakings, are also involved in the transaction, some directly such as the buyers, and others indirectly; these are third parties other than the buyers. It is these relationships which will now be examined although

(1) L. E. SUSSFELD, *Le Factoring*, Presses Universitaires de France, 1968, p. 9 et seq.; J. GERBLER, *Le Factoring*, Dunod 1970, p. 28 et seq.; R. BIANCHI, *Il factoring e i problemi che comporta*, Turin 1970, p. 1 et seq.; A. ZENNER, *Le cadre juridique du factoring*, Centre d'Etudes bancaires et financières, Bruxelles, n° 197, May 1972, p. 6 et seq.

it should first be indicated that the term factoring as used today is applied in practice to transactions other than those which conform strictly to the description given above. In other words, there are in effect several types of factoring (2) (some of which are not applied in Europe) which differ from one another by the more or less varied and complete range of services that the factor offers to his client. However, in the interests of clarity this study will deal with factoring of the classical type - Old Line Factoring (3) - which is the most common form (4) as well as the purest and most important from a commercial point of view, and it will also be restricted, for the moment, to domestic factoring, although the differences between the various types of factoring will be indicated.

(A) The legal relations between the factor and his client

A contract (factoring agreement) is concluded between the factor and his client. It defines their future relations - that is their respective rights and duties - over a period of time which may be determined or undetermined according to whether the contract is concluded for a limited or unlimited period. These rights and duties may in theory vary depending on the contract, the country and the services offered by the factor to his client which, as has already been seen, may vary considerably. There are in fact a certain number of these undertakings which are the very essence of the factoring contract and therefore appear in all such contracts. They will now be considered.

(2) L.E. SUSSFELD, op. cit., p. 4 et seq.; S. PISAR, Aspects juridiques du factoring international in Revue de la Banque, 1968, pp. 490-491; R. BIANCHI, op. cit. p. 14 et seq.

(3) Old Line Factoring has two principal characteristics: the absence of recourse by the factor against the supplier, except with respect to complaints about the goods when the sale has been made in good faith, and notification of the transfer of the debt to the buyer. Furthermore it may take three forms:

a. Conventional Factoring or Conventional Notification Factoring (Old Line Factoring *stricto sensu*) where the factor offers his client the most complete range of services: guarantee against the risk of insolvency, handling of debts, financing.

b. Maturity Factoring or Maturity Notification Factoring where the factor offers the same services as the conventional factor except for financing.

c. Import-Export Factoring or International Factoring which takes the form of a technical application of Old Line Factoring (conventional or maturity) to international transactions and which will be dealt with in more detail in the third part of this report.

(4) The three forms of factoring are practiced in the United States as well as in Great Britain and Europe.

1. Duties of the client vis-à-vis the factor

1. All factoring contracts (5) contain a clause in favour of the factor laying down that the client undertakes to transfer all his book debts to the factor (6) thus preventing him from dealing with other factors at the same time. This principle, which is an essential element of the factoring contract, and which prevents the client from transferring to the factor only those debts which are doubtful or which he fears may not be recoverable, is sometimes mitigated in practice, although one must not be misled as to the significance to be attributed to such mitigation. It may happen that the supplier (for example a company producing chemical products which has several departments exercising different activities) gets the factor to agree that it may transfer to him only the debts relating to a certain part of its activity. However, it must be quite clear that in this case the supplier will be obliged to transfer to the factor all the debts relating to that part of his activity. Lastly, it should be added that such departures from the general rule remain the exception and that they are always expressly stipulated in the contract.

2. The client moreover undertakes to give the factor proof of the dispatch of the goods or of the rendering of the service, which means in practice that he is obliged to deliver him the invoice which must necessarily show that payment is to be made to the factoring company (7). He must also communicate to the factor any information he has about his buyers as well as any information which could simplify the task of recovering the debts; inform him of any circumstances which

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- (5) But not however in Undisclosed Factoring or money without borrowing, a formula characterised by an Italian economic publication as quasi-factoring and the origins of which are attributed to English factors. Here each operation must be the subject of a separate contract. This formula is generally used in connexion with the sale of industrial goods, not consumer goods. Nor may companies providing services employ it.
- (6) Or to be more precise, as will be seen later, to offer to the factor all his book debts. It should be noted that there has been discussion on the question as to whether the expression "all his debts" means that the client is likewise obliged to transfer debts due to his subsidiaries, branches or agencies. The writers, and in particular GAVALDA and STOUFFLET, *Le contrat dit de factoring*, in *La Semaine Juridique*, 8 December 1966, note 98; R. BIANCHI, *op. cit.* p. 61; J.B. BERBIER *op. cit.* p. 65 for the most part favour the extension of the "exclusive" clause to the client's subsidiaries, agencies and branches.
- (7) Such a reference will not be made in "Non Notification Factoring", a formula employed by suppliers who do not wish their buyers to know that the debts owing to them are being financed.

could endanger the debts or of disputes with buyers; give him access to his balance sheet, accounts and books. These duties all reflect the close cooperation which must develop between the client and the factor and the mutual confidence which must stamp their relations.

3. The client is moreover obliged to remunerate the factor in the circumstances and manner provided for in the contract, as they always are. This remuneration of necessity includes a commission - which constitutes in effect the factor's honoraria, in France described as being "pour ses peines et soins, risques et frais", which will be dealt with later - calculated ad valorem on the amounts of the debts factored. The factor will determine the rate of commission in particular on the basis of the following elements: the average length of the credit allowed by the supplier (the longer it is the greater the risk of non-payment which must be borne by the factor; the more onerous the operations of handling, the higher will be the rate of commission); the character of the client's activities: products or services (the general trend of these activities: whether they are in a phase of rapid expansion, stable or contracting); the character of the buyer's activities (the risk run by the factor will vary according to whether or not the buyers belong to the same sectors and according to the extent to which such sectors are exposed to changes in the overall economic position); the number of buyers (the greater their number the lesser the risk but the burden of book-keeping is increased); the quality of the buyers (good or bad payers); the nature, frequency and volume of complaints and disputes (these affect the risk run by the factor as well as the cost of administrative work). To this commission (the rate of which in the United States varies between 0.75 and 2%, in Great Britain between 0.75 and 2.5% and in France between 0.75 and 3%) which the client must always pay to the factor, should be added interest on loans for advance settlement, that is to say cases where the factor makes an advance to the supplier on debts before the date agreed for payment. An annual rate of interest is payable (8.4% in the United States, in Great Britain the Bank of England lending rate + 2% and in France between 6.5 and 8%). It is fixed by the factor according to the debts and to his opinion of his client but interest is collected pro rata temporis.

4. The client must, finally, guarantee the existence of the debt under the maxim "nemo dat quod non habet". The debt will be deemed to exist in fact to the extent that the order has been placed and performance made in accordance with the conditions stipulated in the contract of sale concluded between the supplier and the customer. The consequences of a complaint by the buyer concerning the goods or services supplied will be considered below.

2. Duties of the factor vis-à-vis the client

1. As the client is as a general rule obliged to offer to the factor all the debts due to him (8), the problem arises of whether, and if so to what extent, there is a correlative obligation for the factor to take over all the debts in question. In fact in all factoring contracts, and this is one of the essential characteristics of the contract, the factor reserves the right to chose the debts which he intends to take over. He thus requires that all the debts transferred to him be submitted for his prior approval. In this connexion it is to be noted that in practice factors employ several methods for granting such approval:

a - sometimes they insist on approving each order, which is known as order by order approval: this is the technique used by anglo-saxon factors;

b - others are satisfied with giving a general approval with two possible variations:

i on the basis of a regular rhythm of dispatch (fortnightly or monthly);

ii by fixing for each buyer a permanent ceiling of credit.

Whatever the technique employed however (be it technique a or b i or b ii), the factor may always cancel his approval on condition that the goods have not already been dispatched or that it is no longer possible to prevent such dispatch. Similarly, he will be free to reduce the number of the approvals made under a general cover in respect of goods not yet dispatched or where dispatch may still be prevented (which the factor will usually do if the solvency of the buyer is in doubt or if the ceiling fixed by him has been reached, which may result from adding together various debts owed by a buyer to different suppliers).

2. The principal obligation of the factor is to settle with his client the debts approved by him - at the place of the buyer - at the time agreed or often, as indicated above, before such time. In practice payment is made through a current account opened by the factor in his books in favour of his client. It should be noted that this cash settlement gives rise both in the United States and in Great Britain - but not in France - to a deduction (of between 10 to 20% of the amount of the debt) intended to guard the factor against the risk of commercial disputes. It goes without saying that he is not bound to settle with his client debts which he has not approved: he may however in such cases agree to advances.

(8) See note (5).

3. One of the characteristics of the factoring contract is that the factor settles with the client the debts approved by him and guarantees recovery (9), provided that no complaints are made with respect to the goods by buyers (10). In the event therefore of such a complaint being lodged, the factor does not guarantee recovery of the debt approved by him and in this connexion a distinction should be drawn between cases in which the complaint is made by the buyer before or after the factor has settled the debt with his client;

a. complaints lodged prior to settlement: the client must inform the factor thereof and the latter will not therefore settle the debt. If the client fails to do so, the factor will settle although he is not bound to do so. In the case of there being an express agreement between the parties, the factor will debit the current account of the client in respect of the sum in dispute which has been incorrectly paid.

b. complaints lodged after settlement: the factor may bring a recourse action against the client but he must first prove the existence and the grounds of the buyer's complaint.

If the debt has not been approved then of course there can be no guarantee of recovery by the factor which means that if he has allowed his client an advance and the buyer does not pay, then the client must reimburse him for the amount.

4. As a rule the factor will moreover agree to deal with the handling of the client's accounts and, according to the provisions of the contract, with the factoring of his operations, with the checking of payment dates and with his sales figures etc... In all these cases he will act as financial adviser to the client, sometimes going as far as to dictate his actions in respect of certain buyers.

(9) Except in Non Notification Factoring.

(10) By this must be understood disagreement as to quantity, quality or delivery dates. In this connexion it should be noted that the principle is in practice stated in the contract by the insertion of a clause whereby the guarantee of recovery ceases in the event of the failure of the client to perform his obligations towards the buyer and in particular the following ones: conformity of the quality and the quantity of the goods or services; delivery dates etc... or if non-payment by the buyer is due to Force majeure.

(B) Relations between the factor, the client and other persons affected by the contract of factoring.

The rights and duties of the parties arising under a contract of factoring - the factor and the client - have been described above. Other persons, however, who have not made formal undertakings, are affected by the conclusion of the contract, some directly and others indirectly: they are respectively the buyers and third parties other than buyers. The relations between these different persons will now be considered.

1. Relations between factor, client and buyer

As already mentioned, the transfer of debts must be notified to the buyer ⁽¹¹⁾, which will permit the factor to claim payment from him ⁽¹²⁾. As a general rule the buyer will observe the directives given to him and will pay the factor. It may however happen that the buyer will refuse to make payment, basing himself on a defence which he could invoke against his original creditor - the supplier. Here a distinction should be drawn between defences inherent to the debt which is transferred (for example a defence relating to the non-performance of the contract) and those which are external to it (a right of set-off). While the former may always be raised against the factor, the latter can only if they arise before the transfer of the debt. If the defence raised by the buyer against the factor's request for payment is justified, the factor may bring a recourse action against his client.

2. Relations between factor, client and third parties other than the buyer

It should first be recalled that, like all other contracts, the factoring contract creates a new legal situation which, subject to their own rights, affects third parties also and may be invoked against them (under which conditions will be seen later). A certain number of third

(11) Except in Non Notification Factoring

(12) Two points should however be made:

a. in Non Notification Factoring the recovery of the debt is ensured by the client;

b. in Undisclosed Factoring or money without borrowing, an English technique based on the coexistence of two contracts, the contract of sale and the agency contract concluded between the factor and his client, the factor buys the goods from the supplier whom he designates as his trustee and instructs him to sell them to the true buyer and to recover the purchase price.

parties other than the buyer are concerned - admittedly indirectly - by the conclusion of such a contract: creditors of the buyer, creditors of the supplier, and above all successive assignees of the same debt (that is to say the debt already assigned to the factor by his client). The effects on third parties of the assignment of the debt by the original creditor - the supplier - to the factor must be carefully examined so as to see in which way these interests are protected, and whether the factor or the successive assignee of the debt will have priority. The problem will be considered in the second part of this report.

This report has already described how factoring works in practice. The next question is the extent to which specific rules have been developed in those countries where factoring has been employed and, in their absence, to study the basis on which debts are transferred, which is after all the principal element of the operation.

PART II : FACTORING AND NATIONAL LAW

Preliminary remarks

1. One point should be made at the outset: those countries in which factoring is practiced have not adopted specific rules applicable to it. In consequence factors have no alternative but "to fall back on the general law which is chiefly to be found in the national civil and commercial codes.... Much improvisation was required to adapt to their particular needs long-standing statutory provisions devised for entirely different purposes" (13). It goes without saying that the first part of the statement quoted above concerns neither the United States nor Great Britain. In the United States the basic text for factors is the Uniform Commercial Code (U.C.C.) and in particular Section 9 which deals with secured transactions, and in Great Britain the Law of Property Act 1925. In other words factors use a legal mechanism existing in their national law in order to transfer a debt from the person entitled to payment, the client, to the factor.

2. In the different countries, with the exception of France, the transfer is effected by the assignment of debts, which is governed:

- in Belgium by Article 1690 of the Civil Code as amended by the law of 31 March 1958;
- in the United States by Section 9 of the U.C.C. and, in part, by the law of the various states;
- in Great Britain by Section 136 of the Law of Property Act, 1925;
- in Italy by Articles 1260 to 1267 of the Civil Code;
- in Luxemburg by Article 1690 of the Civil Code;
- in the Netherlands by Articles 668 et seq., 1387, 1417, 1492 and 1569 of the Civil Code;
- in the Federal Republic of Germany by Articles 398 et seq. of the BGB.

In France the mechanism used is that of contractual subrogation under Article 1250 of the Civil Code.

(13) S. PISAR, Aspects juridiques du factoring international, in Revue Banque n. 283, March 1970, p. 251 et seq.

3. The foregoing indications raise the essential question of the validity of the transfer of the debt against third parties, a question which has two aspects: that of the formalities prescribed by national law and that of the effects of the transfer.

(A) The validity of the transfer of the debt vis-à-vis third parties

The problem here is whether the validity of the transfer of the debt vis-à-vis third parties is conditional on one of them having been given notice of it, and in particular the debtor/buyer. If such notice is necessary, the question arises of whether it must be given in any special manner.

As will be seen, the answer to these two questions varies from one country to another

In a first group of countries (Great Britain: Section 136 of the Law of Property Act, 1925⁽¹⁴⁾; Federal Republic of Germany: Article 398 of the BGB; Luxemburg: Article 1690 of the Civil Code; the Netherlands: Article 668 of the Civil Code) the validity of the transfer of the debt vis-à-vis third parties is conditional upon notice of the assignment being given to the debtor. In some countries notification by letter is sufficient (Great Britain and the Federal Republic of Germany) whereas in others notice must be officially served on the debtor by a bailiff (Luxemburg and the Netherlands⁽¹⁵⁾).

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- (14) English law in fact distinguishes between statutory assignments under Section 136 of the Law of Property Act, 1925 and equitable assignments. The former, of necessity absolute and not by way of charge (in that the assignor retains no interest in the property), must be in writing and notice must be given in writing to the debtor. On the other hand, notice to the debtor of an equitable assignment is not indispensable (although in cases of successive assignments of the same debt, the assignee who first gives notice to the debtor will have priority unless he had knowledge of a previous assignment when the debt was assigned to him). The advantage of the statutory assignment is that it permits the assignee to bring an action in his own name without having to join the assignor. It should, in conclusion, be noted that if an assignment is not absolute, it cannot be deemed to be a statutory assignment under Section 136 of the Law of Property Act although it may be valid in equity.
- (15) Unless, in the latter country, the debtor has accepted or acknowledged the assignment in writing. Moreover in practice factors in the Netherlands only have recourse to serving of notice by a bailiff - a cumbersome and costly procedure - when in doubt as to the solvency of the buyer or the sincerity of the seller, in general satisfying themselves by getting the assignor, the client, to indicate on the invoice that payment should be made to them.

In Belgium, on the other hand, under Articles 13 (1) and 16 (3) of the Law of 31 March 1958 concerning endorsement of invoices, the validity of the assignment vis-à-vis third parties is achieved by mere endorsement of the original invoice (or of a certified true copy) (16), the date of the endorsement being binding on third parties (thus derogating from Article 1328 of the Civil Code).

In the United States, by virtue of Sections 9-302 and 9-402 of the U.C.C. (17), the validity of the transfer vis-à-vis third parties - as an assignment by way of guarantee in cases of sale - is conditional on the filing of a financing statement (18), according to procedures which vary according to the states, with one or more public offices. The U.C.C.

(16) A contrary position was adopted by the Brussels Tribunal de commerce to the effect that the validity of the assignment vis-à-vis third parties is conditional on notice by registered letter being sent to the debtor.

The question is far from being settled either by the writers or by caselaw. In our view however the notification of the assignment to the debtor envisaged by Article 16 (2) is not a condition of its validity vis-à-vis third parties but serves merely to establish the bad faith of a debtor who, notwithstanding receipt of notice by registered letter, nevertheless pays the endorser (for support of this view see ZENNER, op. cit., p. 22 et seq.). In practice Belgian factors use a simplified form of notice consisting in a simple annotation on the invoice, only sending a registered letter with an acknowledgment of receipt if they have doubts concerning the honesty of the supplier or the solvency of the buyer (see note (15)).

In general, endorsement, as is well known, is only valid when effected in favour of a bank or of an authorised finance company.

(17) Before the adoption and the implementation of the U.C.C., the assignee who wished to avoid any subsequent dispute had to satisfy certain formalities which varied according to the states:

1) in certain states the English rule was applied according to which only notice of the assignment to the debtor would protect the factor;

2) in others the American rule obtained whereby a written assignment specifying the debt assigned was sufficient to protect the rights of the factor, even in the absence of notice;

3) in yet others statute insisted on bookmaking: the assignment of the various debts to the factor had to be apparent in the supplier's books;

4) finally in other States the Massachusetts rule prevailed under which an assignment without notice was effective, unless a successive assignee had received payment of the debt in good faith or had brought a court action in respect of it, obtained its novation or given proof of the debt by a negotiable instrument.

(18) The financing statement may be filed before the creation of the security interest.

makes provision in almost all cases for a central notice filing. Neither registration nor specification of the debts assigned is required: it is sufficient that the financing operation should result from the document filed. In 1962 an important modification was introduced: notice of the assignment has now the same effect as the filing of a financing statement, it being sufficient for a mere mention to be made on the invoice.

In Italy, the validity of the assignment vis-à-vis third parties is conditional on notice to the debtor or acceptance of it by him (Articles 1264 and 1265 of the Civil Code). It should however be noted that while the writers and the caselaw are concordant in recognising that notice may be given to the debtor by registered letter or by any other adequate means (provided that the letter contains certain particulars)⁽¹⁹⁾, there is however considerable disagreement on the question of the validity vis-à-vis third parties other than the debtor of an assignment notified by registered letter and not by "mezzo di Ufficiale Giudiziario" ⁽²⁰⁾.

In France, subrogation may be invoked against anyone provided that it is express and effected at the same time as payment is made. No other formality is required if the document is dated, the receipt incorporating the subrogation and at the same time indicating that it takes place simultaneously with payment ⁽²¹⁾.

(19) In support of this view see the decision of the Corte di Cassazione: 27 April 1961, no. 498 in Banca, Borsa e Titoli di Credito, 1962, II, 346; 6 May 1966 no. 1162, in Foro Italiano, 1967, 821; 4 February 1969 no. 341 in Giust. Civ. Mass., 1969, 171.

(20) (a) A registered letter is sufficient: BARBIERI in his note on the decision of the Trieste Court of Appeal, 28 April 1960, in Le Corti di Brescia, Venezia e Trieste, 1960, 512 et seq. Above-mentioned decision of the Trieste Court of Appeal.

(b) Requiring notice by "mezzo di Ufficiale Giudiziario": PROVINCIALI in Manuale di Diritto Fallimentare, I, 1964, p. 904; MICCIO in Delle Obbligazioni in Generale, in the Commentario Codice Civile dell'UTET 1971, p. 366; MESSINEO in Manuale di Diritto Civile e Commerciale, 1959, pp. 250-251.

Decisions of the Corte di Cassazione mentioned above under note (19).

(21) In practice what happens is as follows: the supplier issues the invoices corresponding to the goods or products provided and on which it is expressly mentioned that payment must be made to the factor. He regularly communicates to the factor the invoices issued by him with a list of such invoices which the latter returns to him with an indication of the debts approved by him and, in respect of which, payment will be requested by the supplier when he issues the subrogative receipt and effected by entry of a credit on a current account.

In support of this view an unpublished decision of the Cour de Paris of 14 April 1975. Another decision of the Cour de Paris (J.C.P. 1970, II, 16837) should however be noted according to which it is necessary that reference be made in the invoice specifying that a subrogation is being made.

(B) The effects of the transfer of the debt vis-à-vis third parties

The transfer of the debt by means of assignment or subrogation has only the effect of changing the person entitled to payment: the factor becomes the creditor in place of his client (22) although the original contract remains in existence.

The factor who has thus been substituted for the original creditor, the supplier, becomes the owner of the sum owed with all the advantages and disadvantages that may follow:

1. The factor may invoke all the rights of the original creditor, the supplier, and in particular any rights accessory to the debt which were transferred to him at the same time as the debt itself (Article 1692 of the Belgian Civil Code; Article 401 of the BGB⁽²³⁾; Article 1250.1 of the French Civil Code; Section 136 of the Law of Property Act, 1925; Article 1569 of the Netherlands Civil Code and Section 9-318 (1) of the U.C.C.)

2. The debtor may however raise against the new holder any defences available to him against the original creditor. In the various countries the principle of the validity of such defences is accepted, which is perfectly justifiable for on the one hand the new creditor cannot have more extensive rights than the original one while on the other the transfer of the debt should not have the effect of prejudicing the debtor. This general principle which recognises the validity of the debtor's defences does however give rise to difficulties in practice and only the BGB (Articles 404 and 406) and the U.C.C. (Section 9 - 318 (II)) have attempted to deal directly with the question.

By virtue of the above-mentioned articles of the BGB, the debtor may raise against the new creditor any defences against the former creditor which were already available to him at the time of the assignment; he may also set-off against the new creditor a debt owed to him by the former creditor unless, at the time of the creation of that debt, he knew of the assignment or the debt only became due after he obtained such knowledge, provided that, in the latter case, such knowledge came into his possession after the falling due of the debt.

(22) As is very clearly illustrated by Article 398 of the BGB: "... By the conclusion of the contract, the former creditor is replaced by the new creditor".

(23) One of these rights is of special importance: the retention of ownership.

According to Section 9 - 318 (1) of the U.C.C., unless the debtor has made an enforceable agreement not to assert defences or claims arising out of a sale as provided in Section 9 - 206, the assignee's rights are "subject to any defence arising from the contract between the account debtor and the assignor" and "to any other defence.. of the account debtor against the assignor which accrues before the account debtor receives notification of the assignment". A considerable number of court decisions have affirmed the principle according to which the debtor, that is the buyer, may raise against the assignee, the factor, all defences which he could have invoked against the assignor, the supplier, since the factor has acquired the right subject to the same restrictions as those which would have prevailed against the supplier.

It should be pointed out in this connexion that under English law any assignment (whether statutory or equitable) is "subject to equities", that is to say that if an action is brought against the debtor by the assignee, the former may raise any defences (including set-off) which he could have invoked against the assignor at the time he was given notice of the assignment.

In other countries, on the other hand, the situation is much less clear as the texts are silent on the question.

Thus in France, there has been controversy over the question of the validity of defences (24). The prevailing caselaw and opinion of the writers favour the application by analogy of Articles 1291 and 1295 of the Civil Code which provide that the defence of set-off may be raised against the factor when it is invoked in connexion with debts which are liquid, enforceable, reciprocal and which precede the giving of notice of the transfer of the debt. In some court decisions, however, the view has been adopted that a right of set-off against the factor should be recognized in respect of all debts, even though not liquid, enforceable or connected with the debt which has been assigned. In other words if the debt relied upon by the debtor is connected with the debt in respect of which payment is requested (defect in the goods), the defence of set-off may without doubt be raised against the factor to the extent that it precedes the subrogation. On the other hand, if the debtor seeks a set-off against the factor of a debt arising from another relationship, the defence will be admissible only if that debt is certain, liquid and was enforceable before the subrogation took place.

(24) Such a question does not arise when French factors use the mechanism of the protestable invoice ("factures protestables") contemplated by the Ordonnance of 28 September 1967 and supplemented by an implementing Decree of 22 December 1967 which expressly makes provision for the invalidity of the defences listed therein against the banker or finance house to which a debt has been transferred.

In the same manner the question has been posed in the Netherlands and in Belgium where by application of the general law the debtor may invoke, against an assignee in the former country, and the endorsee in the second, - in each case the factor - personal defences which he could raise against the assignor, provided however that they existed at the time of the assignment, as well as defences connected with the debt which has been assigned.

Under Italian law, no statutory rules govern the question of the admissibility of defences in connexion with the assignment of debts. According to the most recent writer on the subject (25), the problem cannot be settled by a simple reference to Articles 1263 and 1248 II of the Civil Code which deal respectively with the effects of the assignment with regard to accessories of the debt and with the invalidity of a set-off of debts arising after the giving of notice or communication of the assignment.

(25) Thus PANUCCIO in *La cessione volontaria dei crediti*, Milan 1955, p. 58 et seq., distinguishes between:

(a) defences going back to the "fonte del credito" and which are based on the non-existence or the nullity of the transaction; they are thus always as valid against the factor-assignee as they were against the assignor;

(b) defences relating to facts arising subsequently to the transaction and which would have the effect of reducing or extinguishing the debt (set-off, novation...). In this connexion he draws a distinction between facts on which the defence is based according to whether they arise before or after the debtor's knowledge of the transaction. If the grounds for the defence arise before the debtor knows of the assignment they are valid against the factor but not so if he obtained knowledge of them subsequently.

(c) defences involving an attack upon the "legittimazione processuale" of the factor-assignee and based on the presence in the contract of assignment of an arbitration clause: these may be invoked by the debtor.

(d) defences relating to the assignment itself (nullity, revocation of the assignment) which are external to the contractual relationship between the assignor and the debtor cannot be raised by the debtor who is not a party to that contract.

The effects of the transfer of the debt with respect to third parties further raises the question of whether the claim of a factor or a third party (26) will prevail in the event of a conflict of interests arising between them. Here again the solution of such conflicts will depend on the country in question and the third party concerned.

In France as a general rule a conflict between the factor and a third party (another assignee of the same debt, a garnishee creditor or the general body of creditors (*masse des créanciers*)) involved in winding up proceedings... will be determined in accordance with the priority in time of the various rights (27).

The situation in the different countries will now be examined.

(a) In the event of successive assignments of the same debt: under English law priority will be accorded to the first assignee to give notice of the assignment to the debtor (28) unless he had knowledge of an earlier assignment when the debt was assigned to him and under American law priority is accorded to the first assignee to file the assignment (U.C.C. Section 9 - 312 (5))(29).

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- (26) According to HUC, in T.X. no. 215, "third parties are those who, while not being parties to the assignment, claim to have rights with regard to the debt which has been assigned and which the assignment may reduce or extinguish".
- (27) The date of the subrogation may be proved in any manner as subrogation which takes place between persons engaged in trade or business in the context of their commercial activities is a commercial act which does not therefore require a set date for the purposes of Article 1328 of the Civil Code.
- (28) This demonstrates the importance of notification of an equitable assignment although it is not necessary for the validity of the assignment.
- (29) Before the entry into force of the U.C.C. the situation was the following:
- (a) certain states applied the English rule whereunder a successive assignee in good faith who first gave notice of the assignment to the debtor had priority over the first assignee;
 - (b) in the majority of states the American rule prevailed according to which priority would be given to the assignee who first gave notice to the debtor of the assignment;
 - (c) in Massachusetts and North Carolina - according to the facts of the case - priority would be accorded to a successive assignee who first notified the debtor of the assignment or to the first assignee on the basis of the principle "first in time"

Under the law of the Federal Republic of Germany one fact is of particular importance: the assignment is already effected by the factoring contract (30) and the delivery of the invoice is only of an informative character: it serves to determine the subject-matter of the assignment but does not bring about the transfer, from which it follows that the factor is entitled to all the debts arising after the conclusion of the factoring contract, even though the supplier then assigns his debts to another person. In other words the factor has absolute priority.

The question does not arise under Belgian law as Article 5 (2) of the Law of 31 March 1958 expressly forbids successive endorsements.

Under Italian law the order of priority is established, in accordance with Article 1265 of the Civil Code, in the following manner: priority goes to the assignment which is first notified to the debtor or which is first accepted by him by an instrument having a set date.

(b) In the event of a conflict between the factor and his client's creditors: in Common Law countries the assignee, the factor, has priority over the assignor's creditors.

One peculiarity of the law of the Federal Republic of Germany gives rise to serious difficulties with regard to factoring: this is the "verlängerter Eigentums vorbehalt" or retention of ownership under Article 455 of the BGB which confers on the supplier of the supplier a privilege not only over the goods supplied but also in respect of debts arising out of the sale of these goods up to the full amount paid for them. The caselaw has not succeeded in resolving the conflict: thus while the Bundesgerichtshof (31) tends to favour the supplier of the goods against the financing bank, the Landesgericht of Düsseldorf (32) decided in favour of the factor, distinguishing factoring from the financing of debts effected by banking institutions and this notwithstanding the decision some years earlier of the Landesgericht of Mainz (33) which resolved the problem on the basis of the priority in time between the stipulations in the factoring contract which include the "Globalzession" and the agreement whereby the first assignor confers on his supplier of goods the "Eigentumsvorschalt".

(30) The caselaw has in effect decided that the Globalzession contained in the factoring contract is not contrary to justice policy (L.G. Mainz).

(31) BGH 24-4-1968, in N.J.W., 1968, 1516.

(32) L.G. Düsseldorf 30-1-1969, Heller Factoring Bank v. Beton Union.

(33) L.G. Mainz 30-6-1966 in B.B., 1966, 1038.

(c) In the event of the bankruptcy of the supplier:

Under the law of the Federal Republic of Germany the factor will, by virtue of the global assignment of the debts, "Globalzession", contained in the factoring contract, call for all the debts in respect of which the supplier is entitled to payment before the commencement of proceedings; in the second place he can claim against all other creditors a right of set-off of the debts appearing in his current account.

American law confers on the factor a lien so that once this is registered the goods sold by the supplier and over which the lien exists cannot be claimed by the general body of creditors.

In English law the principle is that as the trustee in bankruptcy is in the same position as the assignor, an assignment which may be invoked against the assignor may also be invoked against the trustee. Since however this could cause great injustice to the creditors, the caselaw has affirmed the rule that an assignment which can only be made by the assignor after his bankruptcy is void as against the trustee after the commencement of bankruptcy. Furthermore Section 43 of the Bankruptcy Act 1914 provides that a general assignment of book debts by a person engaged in trade or business is void against the assignor's trustee in respect of any debts not paid at the beginning of the proceedings unless the assignment has been registered as a bill of sale.

(d) In the event of the bankruptcy of the buyer:

In certain countries (Belgium (35); Italy, Article 1524 of

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- (34) CHITTY on CONTRACTS, vol. I: General Principles, London, 1968, 23rd edition, no. 1040. It should further be added that the position of a company liquidator who, prior to the commencement of the winding up, has assigned any of its rights is basically the same as that of a trustee in bankruptcy; apart from assignments of future earnings and from particular statutory provisions, a liquidator is bound by an assignment which would be binding on the company itself.
- (35) It is the caselaw which has recognised the system of the retention of ownership clause (which derogates from the provision of Article 1583 of the Civil Code which provides that ownership passes from the seller to the buyer when agreement has been reached on the price) and its application in the event of the buyer's bankruptcy (thus derogating from Article 546 of the Commercial Code which - in order to safeguard the equality of the creditors vis-à-vis each other - rejects the seller's lien over movable property and any claim of his over the goods of a bankrupt; this article was long considered as falling within the domain of "ordre public" with all the consequences flowing therefrom. See SZAMEK, "la réserve de propriété" Edition Donat-Montchrestien, Paris, 1933, p. 111 et seq.

the Civil Code⁽³⁶⁾; Federal Republic of Germany) the factor can invoke against the general body of the buyer's creditors the retention of ownership clause contained in the contract, the benefit of that clause having been transferred to him at the same time as the debt, which will permit him to enforce the rights conferred by it, that is to say to claim ownership of the goods; in other countries however (France⁽³⁷⁾, Great Britain⁽³⁸⁾, the Netherlands), the invalidity of such a clause against the general body of the buyer's creditors has been strongly affirmed.

It has been seen how in different countries factors have, in the absence of specific rules governing factoring operations, adapted the legal means available under their national law to transfer to themselves the debt owing to the original creditor, the supplier. The problems peculiar to international factoring will now be examined.

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- (36) By virtue of this article the retention of ownership is only valid if it appears from a written document bearing a set date - in accordance with the provisions of Article 2704 of the Civil Code - prior to the "pignoramento".
- (37) As is well-known, the Civil Code establishes the principle that the ownership in the goods sold passes to the buyer at the time the contract of sale is concluded.
- (38) In the event of the buyer becoming insolvent and the goods having come into the bankrupt's possession, the seller, and thus the factor, have only a claim against the general body of creditors for a percentage of the price. Section 38 (2) of the Bankruptcy Act, 1914, expressly provides that all the goods which, at the commencement of the bankruptcy, are in the bankrupt's possession, shall be divisible amongst his creditors. English law recognises no exception to the doctrine of reputed ownership. SZAMEK, op. cit. p. 5 et seq.

PART III : SPECIFIC PROBLEMS POSED BY INTERNATIONAL FACTORING

Preliminary remarks

1. While, broadly speaking, international factoring operations reflect domestic factoring practice in that debts must be submitted to the factor for prior approval and that notice must be given to the buyer to pay the new creditor, the factor, nevertheless they appear more complex than domestic factoring as they involve two factors, the export factor (39) and the import factor, who carry out their activities respectively in the country of the exporter - the supplier - and in that of the importer - the buyer. Both factors belong to an international chain or network, that is to say a group of factoring companies, set up in different countries, who have agreed, with or without an "exclusive" clause, to entrust to each other operations regarding buyers in their own countries (40). In effect, international factoring operations raise the delicate problems associated with the risks attaching to the credit - worthiness of the buyer, exchange rates, political instability, natural catastrophes and failure to assign (41). International factoring chains permit these problems associated with international trade to be resolved to a certain extent, albeit imperfectly as these chains have not been implanted in all countries.

(39) It should be stressed that in most countries, apart from France, export factoring amounts to only a small part of the overall activities of factoring companies.

(40) Thus the International Factors network - set up by the First National Bank of Boston - has adopted the "exclusive" principle. Each company covers a territorial area limited by national frontiers and, in respect of international factoring operations, undertakes to transmit export business to its sister company in the country of the importer.

The Heller network, which includes the W.E. Heller Company of Chicago and a number of banks throughout the world, has adopted the same principle.

It would seem on the other hand that the Factors Chain International, grouping together independent factoring companies, has not adopted the "exclusive" principle, thereby permitting the factor to choose his own correspondent.

(41) In France only companies which have taken out a COFACE policy agree to cover political risks, catastrophe and non-transfer. In Italy the contracts at present in use do not contemplate such risks.

2. In practice, international factoring operations proceed as follows: the export factor buys from the exporter - the supplier - his debts against a foreign purchaser and then transfers them to his correspondent - the import factor - to the extent that the latter has previously approved them. As to the respective rôles of the two factors, it should be pointed out that while the export factor determines the conditions of the contract, perhaps makes advances on the debts and in a general way assists the exporter on a commercial level, the fundamental rôle is that of the import factor who approves the debts, handles them, if necessary proceeds to their recovery and alone bears the risks. In other words the export factor requires of his correspondent, the import factor, that he should counterguarantee the operations entrusted to him by the supplier in his country, asking him in some cases to finance the operation (42).

3. It is clear from the foregoing that international factoring operations pose in particular the problem of the protection of the rights of the import factor against third parties and therefore that of the validity of the transfer of the debt to him and of any retention of ownership clause in the contract.

(A) Validity of the transfer of the debt vis-à-vis third parties

In almost all countries - as has been seen above - the transfer of the debt from the supplier to the factor is effected by the assignment of the debt, which has however given rise to some problems in connexion with international factoring, as the assignment of debts is one of the areas of private international law where the rules governing the choice of law show the widest variations (43). The problem

(42) According to SUSSFELD, op. cit. p. 40: "As factoring companies normally have at their disposal considerable funds, they only request financing in two cases:

(a) to cover risks due to changes in the exchange rate, when the export factor fears a devaluation of the currency of the country of the import factor (but as BIANCHI, op. cit., p. 41; note 20, points out, factoring contracts in Italy make no provision for covering such a risk);

(b) to obtain capital at a lower interest rate than that obtaining in their own country".

(43) See RABEL, The Conflict of Laws, a comparative study, Ann Arbor, 2nd edition, pp. 394 to 445.

is further complicated by the fact that the debt will first be transferred to the export factor who will then transfer it to the import factor, which gives rise to two further questions: will the two transfers be governed by the same law? If such is not the case and the formalities laid down by the two laws are different, will failure to respect one of the laws similarly affect the validity of the other transfer? (44).

(B) Validity of the retention of ownership clause

A retention of ownership clause will often be found in the general conditions of sale of the exporter or is inserted in the factoring contract at the request of the import factor. As an accessory of the debt, the benefit of the clause will be transferred to the new creditor - the import factor - at the same time as the debt itself but the possibility for the factor to invoke the clause against third parties will pose some problems as certain national laws do not recognise it whereas others use it widely (as is the case in the Federal Republic of Germany), while yet others employ it only to a limited extent (as in France). French case-law, as is well known, refuses to recognise the validity of such clauses whenever a foreign creditor of the buyer seeks to invoke it against the latter's creditors. This means in effect that a French or foreign factoring company cannot invoke such a clause against the creditors of a French importer. In other words international factoring operations many here again give rise to a conflict between different systems, which demonstrates the need for seeking a uniform solution.

(44) A trend would seem to be emerging in favour of the application of the law of the domicile of the debtor / buyer - in determining the formalities of the assignment and the giving of notice. In consequence the import factor can only validly invoke the transfer of the debt against third parties if the supplier and the export factor have respected the formalities laid down by the law of the domicile of the debtor / buyer.

Another trend based on "inter-factor custom" consists in the submission of the transfer to the law of the common domicile of the debtor / buyer - and of the import factor.