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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

STUDY GROUP FOR THE PREPARATION OF UNIFORM RULES

ON THE FACTORING CONTRACT

R E P O R T

of the Secretariat of UNIDROIT on the third session
of the Group held in Rome from 19 to 21 April 1982

Rome, July 1982

1. The UNIDROIT Study Group for the preparation of uniform rules on the factoring contract held its third session at the seat of the Institute in Rome from 19 to 21 April 1982. The work accomplished resulted in the preliminary draft uniform rules on certain aspects of international factoring which were approved on 21 April 1982 and the text of which is reproduced in ANNEX I to this document.

2. The purpose of this report on the third session of the Group is to indicate the principal decisions taken by it as well as the most important amendments to the text of the preliminary draft articles approved by the Committee on first reading at its April 1981 session as a basis for future discussion.

3. The April 1982 session was opened by the President of UNIDROIT, Mr Mario Matteucci. He welcomed the participants, the list of which appears in ANNEX II. The session consisted of five meetings, chaired by Professor Jean-Georges Sauveplanne, Netherlands member of the Governing Council of UNIDROIT. A Drafting Committee, which held one meeting, was also constituted.

4. The Group was seized of the preliminary draft articles approved on first reading in April 1981 (hereafter referred to as the 1981 text), of the Report of the Secretariat of UNIDROIT on the second session of the Group (Study LVIII - Doc. 10) and various documents and observations which are reproduced in Study LVIII - Doc 11, including in particular a report of Professor R.M. Goode who had represented the Institute at a meeting of the Legal Committee of Factors Chain International, held in Dusseldorf on 7 September 1981, at which the preliminary draft had been the subject of discussion.

5. After adopting the draft agenda for its third session (see ANNEX III) and before proceeding to a second reading of the 1981 text, the Group began by examining a certain number of questions which had been left open at its second session and in particular those articles which had been placed in square brackets.

6. The Group first considered the problem of priorities, that is to say the possibility of competing claims of a factor and of a third party (including a trustee in bankruptcy or a liquidator) both of whom have rights over the receivables assigned by the supplier. This matter was dealt with in Article 9 and at its 1981 meeting the Group had not been able to reach a satisfactory solution. Both the article and the phrase stating that the order of priority between a factor and a third party is to be determined by the law of the place in which the supplier has his principal place of business had therefore been placed in square brackets. The Group had hoped to be able to formulate a rule of substantive law on this matter but this now appeared to be too difficult. Moreover, the search for a conflicts rule, in particular with the assistance of the Secretariat

of the Hague Conference on Private International Law, had led to fairly clear solutions but on detailed examination each of these was shown to present drawbacks. The idea was also rejected of combining a rule of substantive law with a conflicts rule as was that of laying down a rule limited to priorities among factors. Article 9 of the 1981 text was in consequence deleted and the Group preferred, at the present stage, to include no rule on this question.

8. The Group then turned to Article 3 which had likewise been placed between square brackets. This article dealt with the validity of factoring contracts and contemplated the assignment of both existing and future receivables, thus touching also on the problem of the validity of the assignments themselves. The 1981 text of the article reads as follows:

"It is sufficient for the validity of the factoring contract that there be an express agreement providing for the assignment by the supplier of existing and future receivables, even though the contract does not specify them individually."

In the revised version of Article 3 which has now been adopted without the square brackets, reference is no longer made to the validity of the factoring contract, which is to be determined by the law applicable to that contract. The rule laid down is a limited one. At the beginning of the article it is stated that what is to follow applies to the relation between the supplier and the factor. From this starting point, the article then provides that a contractual provision for the assignment by the supplier of existing or future receivables shall be valid, even though the contract does not specify them individually. However, the receivables must be described in such a way that at the time when they come into existence they can be identified as falling within the contract. This rule thus makes the assignment of future receivables possible to the extent that the clause in the contract making provision for their assignment describes them sufficiently clearly for it to be known that the contract applies to them and indeed contemplated them. Under no circumstances however does the article permit the assignment of receivables which are uncertain. Paragraph (b) of Article 3 settles the question of the time at and manner in which the assignment of future receivables is to take effect. It provides in effect that "a provision in the factoring contract by which future receivables are assigned shall have effect according to its terms without the need for any new act of transfer by the supplier after the receivables have come into existence".

9. The Group then proceeded to a revision of the other articles of the 1981 text.

Article 1

10. The Group decided to retain the terms "receivables" in English and "créances" in French. The requirement that the receivables must arise from the sale of goods or the supply of services to trade or professional debtors was removed from the article as it was deemed inappropriate for this restriction to be included in a definitions article. It was therefore moved to Article 2. On the other hand, it was thought that in the enumeration of the services which may be provided by the factor, the text should not speak of "one or more of the following services" but rather of "at least two of the services" which are listed in paragraph 2 of Article 1. While the 1981 text provided that the factor was responsible for maintaining the accounts, the Group decided that this should be an optional service offered by the factor and not a compulsory one. Finally, the Group deleted the twelve month time-limit laid down for the payment of the receivables as from delivery of the goods or supply of the services. The new Article 1 now contains three paragraphs. The third is almost identical to paragraph 2 of the 1981 text and provides that "in these rules, references to "sale of goods" and "sale" shall, except as otherwise included, include the supply of services".

Article 2

11. The first paragraph has undergone only very slight changes. The application of the rules is still limited to international factoring contracts, but it is specified that these are factoring contracts "relating, wholly or in part, to receivables arising from a contract for the sale of goods between parties whose places of business are situated in different States". The question was raised as to whether the scope of application should be limited by a reference to different Contracting States but it was decided not to adopt the suggestion at this stage. Finally, in cases where a party has more than one place of business it was agreed to align the French text on the English with the effect that the former now speaks of the place of business to be taken into consideration as being that "qui a la relation la plus étroite avec le contrat de vente et son exécution". Paragraph 2 now consists of two sub-paragraphs. Sub-paragraph (a) has taken over the language formerly in Article 1 which requires that the receivables must "arise from the sale of goods to trade or professional customers (debtors)", the two terms being used to avoid doubts relating to the word "debtors" in English. The French text speaks of "clients (debiteurs) commerciaux ou professionnels". The word "client" in the French text translates, it should be noted, the English term "customer", which is often used in factoring parlance to designate the customer of the factor, that is to say the supplier. Sub-paragraph (b) states that the "notice of assignment of the receivables is to be given to the debtors", thus excluding from the scope of the rules non-notification factoring. The words "at or about the time of the sale" which appeared in the 1981 text have been deleted while the rules regarding the manner of notification are grouped together in Article 6.

12. Article 3 has already been discussed in paragraph 8 above.

Article 4

13. This article provides that the assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting it. The language of the provision has been clarified and broadened. Instead of saying, as did the 1981 text, that the assignment shall be effective notwithstanding any provision in the contract of sale prohibiting it, it is now stated that it will be effective "notwithstanding any agreement between the supplier and the debtor prohibiting such assignment".

It was considered that this article would greatly encourage the development of factoring although some were of the opinion that it might be difficult to include the rule in certain legal systems and that its presence could perhaps constitute an argument in favour of limiting the scope of the rules to Contracting States, as had been proposed in connection with Article 2. The Group however took no decision on the matter.

Article 5

14. This article is concerned with the possibility for the supplier to transfer to the factor all or any of his rights under the contract of sale, including the case of reservation to the supplier of title to the goods. Whereas the 1981 text provided that an assignment may validly provide for the transfer to the factor of all or any of the supplier's rights under the contract of sale, it is now stated that "the factoring contract or an assignment made pursuant to it may validly provide for the transfer, automatic or otherwise, to the factor of all or any of the supplier's rights under the contract of sale". Moreover, instead of saying "including any provision in such contract reserving title to the supplier", the text now reads "including any provision in such contract reserving to the supplier the title to the goods".

Article 6

15. This provision deals with the effectiveness of the assignment against the debtor and with the manner of notification. Paragraph 2 of the 1981 text has been deleted. It provided that "in the case of an assignment prohibited by the contract of sale, such notice must be in writing and must contain a statement that the assignment is governed by these rules". The remainder of the article permitted notice of the assignment to be given either in writing or in a manner which complied with the requirements of the law of the place at which the debtor had his place of business if the latter allowed a less strict form. The requirement of writing containing the statement that the assignment was governed by the present rules was linked to Article 4 which permitted the assignment of the receivables by the supplier to the factor even if it was prohibited by the contract with the purchaser. The Group has now extended the requirement of writing to notice in respect of all assignments and the less strict rule allowing reference to the local law has not been

retained. The French text no longer speaks of "avis" but of "notification" as in Article 2. It has been decided that notice must always be in writing and must indicate that the assignment is governed by these rules so that written notice and a reference to the uniform rules are now cumulative requirements for all assignments. The writing giving notice of the assignment must indicate sufficiently clearly the receivables which have been assigned and the person to whom the debtor is required to make payment. Finally, as the words "at or about the time of sale" at the end of Article 2, sub-paragraph (b), have been deleted, Article 6 now contains a new paragraph 2 which states that "a notice of assignment shall be effective for the purpose of paragraph 1 of this article only in relation to a receivable arising under a contract which has been concluded at or before the time the notice is given".

Article 7 (new)

16. This provision answers a number of questions left open at the end of the second session. In the first place, it provides that for his debt to be discharged, the debtor who makes payment to the factor must do so in good faith. In other words, he must not have knowledge of any reasons why he should not pay the factor. Examples are where he has been given notice from another person not to make payment, or given notice to make payment to another person, for instance a trustee in bankruptcy. If, however, he has made payment in good faith, he is discharged. The article also stipulates who it is who must give notice to the debtor that he must pay the factor. This may be the supplier himself and in these circumstances everything is clear. It may be the factor, in accordance with actual or apparent authority conferred on him by the supplier. In the case of actual authority again no doubts arise; the debtor has been given notice. In the case of apparent authority however the debtor who has made payment in good faith is discharged from his liability if he made payment "without having reason to know of any other person's right to payment ...". If these conditions are satisfied, the debtor is completely discharged with regard to the amount specified in the notice of assignment even though in actual fact the receivable has not been validly assigned by the supplier to the factor and even though the right to payment of the receivable was vested in a third party. It is sufficient that when making payment the debtor believed in good faith that he should pay the factor and that he had no grounds for suspecting that the receivable belonged to a third party.

Article 8

17. The present text has been taken over from paragraph 1 of the former Article 7. Although the French version has not been amended, the English text, which previously translated the French formula "sous réserve des dispositions de l'article 4" by "subject to Article 4", now reads "except as provided in Article 4 ...". Paragraph 2 corresponds to the second

paragraph of the former Article 7 with some amendments. The previous text stated that "the debtor may also exercise against the factor any right of set-off available to the debtor against the supplier at the time the debtor received notice of the assignment, to the extent to which such right of set-off relates to claims which the debtor might have had against the supplier". The new wording is clearer and provides that "the debtor may also exercise against the factor any right of set-off in respect of claims existing and available to the debtor at the time the debtor received notice of the assignment against the supplier in whose favour the receivable arose".

Article 9

18. The present text takes the place of the former Article 9 concerning priorities which was deleted by the Group. It corresponds to Article 8 of the 1981 text and stipulates that "without prejudice to the debtor's rights under Article 8, non-performance or defective or late performance of the contract of sale by the supplier shall not entitle the debtor to recover money paid by the debtor to the factor". The text is clear: if the debtor/purchaser has paid the factor although the supplier/seller has not performed the contract of sale or the performance is defective or late, the former cannot turn against the factor to recover his money. The factor is not liable for such non-performance or defective or late performance and the debtor must, where appropriate, proceed against the supplier.

Article 10

19. This provision is taken over almost word for word from the former Article 10. As regards paragraph 1, both versions are unchanged. However, as was the case with the 1981 text, the French version provides that "le factor ne doit, du fait du seul transfert de la propriété des biens, tel que prévu à l'article 5, encourir une responsabilité envers les tiers du fait des dommages matériels ou personnels causés par ces biens". The English text speaks of "transfer of title to goods to the factor" (transport de la propriété des biens au factor) which last words are missing in the French version. Moreover, the English speaks of "liability to a third party" and the French of "responsabilité envers les tiers". Finally the question was posed as to whether, in the French version, instead of saying "le factor ... ne doit encourir une responsabilité", it might not be more in line with the intention of the drafters to say "le factor ... n'encourt pas de responsabilité", thus translating the English "the factor shall not ... incur liability".

20. Two amendments have been made to paragraph 2. The reference to the "third party" has been deleted as the term could be ambiguous when one thinks of the debtor in relation to the factoring contract. Now it is stated that nothing in the article shall affect the liability of the factor where he sells or otherwise disposes of the goods to a person

who is not the supplier, another factor on the debtor. The factor is protected under paragraph 1 in respect of damage caused by goods of which he has temporarily become the owner by virtue of Article 5 but he becomes liable if, acting as the owner, he puts them back into circulation by selling or otherwise disposing of them. On the other hand, he is not liable for damage caused by the goods during the period when he is owner for a very short time before title passes to the debtor/purchaser or repasses to the supplier/seller, for example when the goods are rejected by the debtor/purchaser.

Article 11

21. This last article of the preliminary draft is also very similar to the 1981 text although certain clarifications have been made. It is sufficiently brief to be cited in full in both versions. The former text stated that "the present rules, including this article, shall also apply to subsequent assignments of the receivables by the factor to another factor, whether the establishments of the factors are situated in the same State or in different States". The new text provides that "the present rules shall also apply to subsequent assignments of the receivables by the factor to another factor as if the first factor were the supplier and the other factor were the initial factor, whether the places of business of the factors are situated in the same State or in different States". The words "including this article" were deemed to be superfluous and the phrase underlined was added. Finally, it should be noted that a proposal was made to speak in the French text of "cessions ultérieures" rather than "cessions successives" which had been taken over from the English while the English wording was amended by replacing the words "the establishments of the factors" by "the places of business of the factors", so as to retain the terminology of Article 2 of the preliminary draft which is that to be found in the most recent Conventions.

22. At the end of the session, the Group took stock of the questions which had been settled and of those which it had not deemed it appropriate to make the subject of uniform rules. Thus, the Group did not, at least for the present, proceed to a limitation of the scope of application of the rules to Contracting States only. The validity stricto sensu of the contract between the factor and the supplier and the content of that contract, as well as contracts between factors, are not contemplated by the present rules. The Group was of the opinion that it was not advisable at the present time to intervene in an area where the detailed contracts which are used by the practitioners and their customers seem, unless further information indicates otherwise, to give satisfaction. However, since the rules do not deal with these questions, the Group decided no longer to speak of their relating to the factoring contract and adopted the title "Preliminary draft uniform rules on certain aspects of international factoring". Finally, since the Group considered it preferable not to lay down rules concerning priorities between factors and third parties and between factors themselves, the text does not deal

with the question of the dating of assignments, the publicity to be given them or their registration, nor yet again with the preferred claims of States in respect of fiscal matters.

23. In conclusion, the Group considered that the text could now be diffused among circles interested in factoring so as to obtain the greatest number of reactions and observations. It was suggested that it would certainly be desirable for the preliminary draft to be submitted to round tables and to symposia where the rules could be considered, in the same way as had UNIDROIT's preliminary draft on leasing, the success of which symposia was well known. After this diffusion of the text and consultation of the interested circles, it would then be possible to proceed to an analysis of criticisms and suggestions made with regard to the text and then perhaps reconvene the Study Group to see whether the draft should be enlarged or amended or, if it was deemed to be sufficiently complete, pass on to a new stage, such as its submission to Governments for observations or even to a Committee of Governmental Experts for consideration.

PRELIMINARY DRAFT UNIFORM RULES ON CERTAIN ASPECTS OF
INTERNATIONAL FACTORING AS APPROVED BY THE UNIDROIT
STUDY GROUP FOR THE PREPARATION OF UNIFORM RULES ON THE
FACTORING CONTRACT ON 21 APRIL 1982

Article 1

1. For the purpose of the present rules, "factoring contract" means a contract concluded between one party (the supplier) and another party (the factor) by which the factor is to provide at least two of the services specified in paragraph 2 of this article and the supplier is to assign to the factor on a continuing basis, by way of sale or security, receivables arising from the sale of goods.

2. The services referred to in paragraph 1 of this article are finance, the maintenance of accounts, the collection of receivables and protection against credit risks.

3. In these rules references to "sale of goods" and "sale" shall, except as otherwise indicated, include the supply of services.

Article 2

1. The present rules shall apply in relation to international factoring contracts, that is to say, factoring contracts relating, wholly or in part, to receivables arising from a contract for the sale of goods between parties whose places of business are situated in different States. Where a party has more than one place of business, his place of business for the purpose of this article shall be that having the closest relationship to the contract of sale and its performance.

2. The present rules shall apply only in relation to factoring contracts pursuant to which:

- (a) the receivables to be assigned arise from the sale of goods to trade or professional customers (debtors), and
- (b) notice of assignment of the receivables is to be given to the debtors.

Article 3

As between the supplier and the factor:

- (a) a contractual provision for the assignment by the supplier of existing or future receivables shall be valid, even though the contract does not specify them individually, if they are so described that at the time when they come into existence they can be identified as falling within the contract;
- (b) a provision in the factoring contract by which future receivables are assigned shall have effect according to its terms without the need for any new act of transfer by the supplier after the receivables have come into existence.

Article 4

The assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment.

Article 5

The factoring contract or an assignment made pursuant to it may validly provide for the transfer, automatic or otherwise, to the factor of all or any of the supplier's rights under the contract of sale, including any provision in such contract reserving to the supplier the title to the goods.

Article 6

1. Subject to paragraph 2 of this article, the assignment shall be effective against the debtor if notice of the assignment to the debtor:

- (a) is given in writing and reasonably identifies the receivables which have been assigned and the person to whom the debtor is required to make payment; and
- (b) states that the assignment is governed by these rules.

2. A notice of assignment shall be effective for the purpose of paragraph 1 of this article only in relation to a receivable arising under a contract which has been concluded at or before the time the notice is given.

Article 7

If the debtor in good faith and without having reason to know of any other person's right to payment of a receivable makes payment to the factor pursuant to a notice of assignment given by the supplier or by the factor with the supplier's actual or apparent authority, the payment shall be effective to discharge the debtor's liability pro tanto even if:

- (a) the receivable had not been validly assigned by the supplier to the factor; or
- (b) the right to payment of the receivable was vested in a third party.

Article 8

1. Except as provided in Article 4, in a claim by the factor against the debtor for payment of a receivable arising under a contract of sale the debtor may set up against the factor all defences of which the debtor could have availed himself under that contract if such claim had been made by the supplier.

2. The debtor may also exercise against the factor any right of set-off in respect of claims existing and available to the debtor at the time the debtor received notice of the assignment against the supplier in whose favour the receivable arose.

Article 9

Without prejudice to the debtor's rights under Article 8, non-performance or defective or late performance of the contract of sale by the supplier shall not entitle the debtor to recover money paid by the debtor to the factor.

Article 10

1. The factor shall not, by reason only of transfer of title to goods to the factor as provided by Article 5, incur liability to a third party for loss, injury or damage caused by the goods.

2. Nothing in this article shall affect the liability of the factor where he sells or otherwise disposes of the goods to a person who is not the supplier, another factor or the debtor.

Article 11

The present rules shall also apply to subsequent assignments of the receivables by the factor to another factor as if the first factor were the supplier and the other factor were the initial factor, whether the places of business of the factors are situated in the same State or in different States.

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AGENDA

1. Approval of the draft agenda.
2. Consideration of the preliminary draft rules approved by the Study Group on first reading at its second session, held in Rome from 27 to 29 April 1981 (Study LVIII - Doc. 10).
3. Other business.