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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

with

EXPLANATORY REPORT

(prepared by the Secretariat of UNIDROIT)

Rome, January 1983

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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.

EXPLANATORY REPORT

prepared by the UNIDROIT Secretariat

I

BACKGROUND TO THE PRELIMINARY DRAFT UNIFORM RULES

1. At its 53rd session, held in Rome from 4 to 7 February 1974, the Governing Council of UNIDROIT decided on the basis of a memorandum submitted by the Secretariat to include in the Work Programme for the triennial period 1975 to 1977 the subject of the assignment of debts in general and more particularly that of the contract of factoring. It also asked the Secretariat to present a preliminary study on the contract which would give the Council the possibility to take a decision on the order of priority to be accorded to this topic with a view to the elaboration of uniform rules(1).

2. The Governing Council was seized of the preliminary report prepared by the Secretariat(2) at its 55th session, held in Rome on 16 and 17 September 1976. It noted in particular that the report, which dealt essentially with three questions, the practical aspects of factoring operations, factoring under national law and the specific problems raised by international factoring, had together with a questionnaire also prepared by the Secretariat been communicated to a restricted number of academic lawyers who were experts on the matter. The Governing Council agreed to authorise a wider distribution of the report and the questionnaire, especially to practitioners(3) so that a decision might be taken at its 56th session on whether steps should be taken towards the convening of a Study Group or a Committee of Governmental Experts to work out uniform rules on the contract of factoring, and at that session, held in Rome on 19 and 20 May 1977, it decided to set up a restricted group of members of the Governing Council, perhaps assisted by one or more experts on factoring, to examine an analysis of the replies(4) to the questionnaire(5).

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(1) Minutes of the 53rd session of the Governing Council, p. 20.

(2) UNIDROIT 1976, Study LVIII - Doc. 1.

(3) Minutes of the 55th session of the Governing Council, p. 44.

(4) UNIDROIT 1977, Study LVIII - Doc. 3.

(5) Minutes of the 56th session of the Governing Council, p. 33.

3. The restricted group, composed of Professor Jean Limpens, Chairman, Professor Royston M. Goode, Professor Tudor Popescu and Mr Heinrich Johannes Sommer, met in Rome on 13 and 14 February 1978 and after examining the replies to the questionnaire it concluded, inter alia, that it would be desirable to elaborate uniform rules on factoring given the significance of factoring as a new method of financing international trade which is capable of responding to needs which other financing techniques fail to meet to the same extent. The group also considered that the uniform rules should, initially at least, be restricted to international factoring although it was suggested that rules on international factoring would not fail to influence the various domestic laws. With regard to the criteria which should define international factoring, it was noted that in practice the concept of international factoring is dependant on a basic relationship of an international character so that the future rules should be limited to factoring relations concerning debts arising out of sales contracts or of contracts for the provision of services between parties whose places of business are situated in different States.(6)

4. These, together with the more detailed conclusions of the group, were brought to the attention of the Governing Council at its 57th session, held in Rome from 5 to 7 April 1978(7), and in accordance with the powers conferred upon him by the Council the President of the Institute constituted a Study Group for the preparation of uniform rules on the factoring contract.

5. The Study Group held three sessions in Rome, the first on 5 and 6 February 1979 under the chairmanship of Professor Goode, deputising for Professor Limpens, Belgian member of the Governing Council of UNIDROIT, while the second and third, held from 27 to 29 April 1981 and 19 to 21 April 1982 were, following the death of Professor Limpens, chaired by the Netherlands member of the Governing Council, Professor Jean Georges Sauveplanne.(8)

6. At the conclusion of its third session, the Study Group adopted the preliminary draft uniform rules on certain aspects of international factoring as reproduced above. These will be submitted to the Governing Council for consideration at its 62nd session, to be held in Rome from 4 to 7 May 1983.

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(6) See UNIDROIT 1978, Study LVIII - Doc. 4 for the report on the session.

(7) Minutes of the 57th session of the Governing Council, pp. 20 - 23.

(8) The reports on the three sessions are contained in UNIDROIT 1979, Study LVIII - Doc. 7, UNIDROIT 1981, Study LVIII - Doc. 10 and UNIDROIT 1982, Study LVIII - Doc. 13 respectively.

II

GENERAL CONSIDERATIONS

7. Although it has a long history in the United States of America, factoring as it is understood today is a comparatively recent phenomenon outside of North America and especially in those countries which do not have a Common Law tradition. In these circumstances a few introductory remarks explaining the nature of factoring operations and their spectacular growth over the last twenty years or so would seem to be in order.(9)

8. Factoring is without doubt today one of the most effective ways for a small or medium size business selling raw materials or consumer goods or providing services to finance the trade credit it grants to its customers. True, it may rely on its own resources or on credit provided by the bank or on that available from its own suppliers but inflation coupled with high interest rates and the current low supply of risk capital have led many businessmen to seek alternative forms of financing such as factoring, with the many services which it offers.

9. The concept of factoring, it has been pointed out, is simple in that it is a continuing arrangement whereby a finance company, the factor, purchases or takes a security over the trade debts of a merchant, manufacturer or provider of services, the supplier, and in most cases undertakes to recover the debts from the latter's customers. Usually, although not invariably, notice of the transfer of the debts (receivables) which is in most countries accomplished by their assignment, will be given to the customers of the supplier on the invoice together with instructions to pay the factor. Again it is normal, although not always the case, that the factor will make no provision for recourse against the supplier in the event of the insolvency of the customer, subject to his approval of the latter's credit standing, and it is also usual for the factor to relieve the supplier of the burden of keeping the accounts. In addition to the supplier's paying the factor for these services a fee which ranges from a fraction of 1% to some 2% of the face value of the invoice representing each debt, the supplier may also pay the factor a discounting charge, in return for which he obtains a substantial part of the receivables arising from each debt as soon as the goods have been sold and delivered, the remainder (usually some 20%) being retained by the factor until

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(9) Paragraphs 8 to 11 owe much to a paper by Mr Frederick R. Salinger, Director of Anglo-Factoring Services, Ltd., which appears as Chapter 26 in the present edition of Sheldon and Fidler's "Practice and Law of Banking".

the customer pays or until a date calculated by reference to the average period of credit taken by the supplier's customers. The amount retained by the factor may be set off by him against his rights in regard to disputes or claims raised by customers.

10. As a rule, the factoring contract concluded between the supplier and the factor, whereby the supplier undertakes to assign or actually assigns his trade debts to the factor, will be of a duration of at least one year. The factor will decide whether he will purchase the debts of a given customer as well as determining any credit limit he may establish in respect of such a customer. As stated above, the supplier's invoice will in the case of notification factoring, with which the draft uniform rules are concerned, give notice to the customer of the assignment to the factor with instructions to pay him. Copies of the invoices will be sent to the factor who will credit the supplier with the value of the invoices (less his charges) and debit the accounts of the customers, the supplier being free to draw on the credit in his account subject to the arrangements with the factor.

11. Finally in this brief exposé of the rudiments of factoring, it should be recalled that while the factor will normally accept responsibility for payment of debts arising from the insolvency of a customer, always provided that the supplier has not exceeded his credit limit or t that the supplier is not in breach of his undertaking that the receivables accepted by him are free from rights of set-off by his customers, the factor will not accept responsibility for any breach of contract by the supplier against his customer, for example by non-performance, defective or late performance, or for the accuracy of any invoices and credit notes which have been issued.

12. If the mechanics of factoring operations are relatively straight forward, the converse is true in many countries of the law applicable to them. As is the case with leasing, in respect of which uniform rules are also under preparation within UNIDROIT, it has often been necessary to adapt the development of factoring to conform to a pre-existing legal framework which was not designed to accommodate it. The attendant difficulties in the various legal systems are still further exacerbated in international factoring, not only by the wide variations in national law but also by the frequent uncertainty as to which law will apply.

13. In these circumstances the Study Group on the factoring contract fully endorsed the opinion of the restricted group of members of the Governing Council that it would be opportune to draw up uniform rules on factoring although it recognised that the task would not be an easy one and that only by not being over-ambitious would it be possible to prepare rules likely to be acceptable to a large number of States.

14. The Group decided therefore in the first instance to restrict the scope of application of the rules to international factoring, that is to say to cases where the contract for the sale of goods or the supply of services under which the receivables to be factored arise is concluded between parties with places of business in different States. The Group considered that while it might be desirable in theory to contemplate the preparation of uniform rules on factoring at national as well as international level, there might well be a strong reluctance on the part of many States to accept changes to well established principles of law which are of much more general application than simply to factoring operations. On the other hand, the Group expressed the hope that States would, in the course of time, be prepared to extend the application of the uniform rules to domestic operations. In the meantime, however, the restriction of the scope of application to international factoring was seen as an advantage in that it would permit some more significant steps in the direction of unification to be taken than might otherwise be the case.

15. One important limitation of a general character on the subject-matter of the rules should also be noted from the outset. In effect, they seek to interfere as little as possible with the contractual relations of suppliers and factors and of factors inter se, although one exception to this approach in the latter regard is constituted by Article 11. Generally speaking it was acknowledged that the regulation of these relations is best left to the parties, between whom many practices and customs have grown up, a large number of which have been embodied in general conditions to be found in the agreements concluded between suppliers and factors and in the arrangements between factors themselves. The Group was also of the opinion that the rules should not attempt to regulate the validity of the factoring contract itself, which should be determined by the applicable law, that is to say usually by the law of the State where the supplier and the factor (in international transactions normally the export factor) have their places of business. In this context therefore the draft uniform rules are limited to a definition of the factoring contract in Article 1 and of international factoring contracts in Article 2, paragraph 1 as well as a further specification in paragraph 2 of that article of the type of factoring contracts to which the rules are to apply.

16. The bulk of the draft is concerned with the validity and effectiveness of assignments of receivables and a number of provisions such as Articles 3, 4, 5, 7 and 10 may be seen as offering incentives for the development of factoring as an instrument for the promotion of international trade. Thus Article 3 removes certain obstacles to the validity of assignments of future receivables, and dispenses with the need for a new act of transfer in respect of such receivables after they have come into existence, as distinct from provisions in the factoring contract assigning them; Article 4 provides that the assignment of a receivable to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment; Article 5 allows the supplier and the factor to provide for the transfer of the supplier's rights under a contract of sale including the benefit of a reservation of a title clause; Article 7 protects the debtor in certain cases where he has made payment to the factor instead of to the person entitled to payment and finally Article 10 very substantially limits the cases in which the factor who becomes owner of the goods under a reservation of title clause may be liable to third parties for loss, injury or damage caused by the goods. Article 6 is the one article which might at first sight seem to be contrary to the general philosophy underlying the draft of facilitating factoring. This provision lays down the formalities necessary for notice of the assignment to the debtor to be effective against him and here it should be borne in mind that particular considerations came into play (see paragraphs 38 to 41 below).

17. The two remaining articles of the draft to which reference has not yet been made are Articles 8 and 9 which deal on the one hand with the defences and rights of set-off of the debtor against the factor and on the other with the extent to which the debtor may, in the event of non-performance or defective or late performance of the contract of sale by the supplier, recover money which he has paid to the factor.

18. It will therefore be seen that the draft is, apart from questions of definition and scope of application, concerned essentially with three problems, namely the validity of assignments of receivables as between the supplier and the factor, the circumstances in which such assignments are effective against the debtor, and the relations between the debtor and the factor arising out of the assignment. There was however much lengthy discussion within the Group as to whether the rules should also include provisions concerning priority in the event of conflicting claims over the receivables between the factor and third parties. In this connection the Group noted that there exist wide discrepancies in approach from one country to another, some systems granting priority to the first assignee of a receivable, others to the first assignment to be notified

to, or accepted by, the debtor, or alternatively to the first of which the debtor receives notice, and yet others to the first to be filed in a public register. In addition, it was pointed out that the possibility of laying down an acceptable uniform rule of a substantive character in this connection would seem to be even less likely if one bore in mind the variety of situations, in which priority questions could arise opposing a factor to, for example, a bank, a trustee in bankruptcy, a sales agent, a preferred creditor, another factor or a person availing himself of a reservation of title clause, not to mention the complications created by fiscal claims over the receivables. It was therefore agreed that the only prospect of success lay in solving the problem on the basis of a conflicts of law rule Here again however insuperable problems were encountered in the elaboration of a uniform rule, given the difficulties in determining the connecting facter as the priority question might, according to the circumstances, be characterised as one relating to the law of contracts, tort law, the law of property, quasi-contract, equitable rights, restitution etc. In these circumstances the Group decided that it would regrettably have to leave the whole problem of priorities between the factor and third parties to be decided in accordance with whatever might be the applicable national law.

19. Finally, the Committee took no final decision on the question of the form to be given to the future uniform rules although the general feeling was that a Convention would be the most appropriate instrument as the very nature of factoring operations, involving the assignment of receivables to a person not a party to the original sales contract, would not permit the problems in issue to be solved by including the content of the uniform rules in contracts concluded between those parties. In any event the question of the final form of the rules was, it was noted, one which is traditionally decided in UNIDROIT by a Committee of Governmental Experts and the problem will therefore be examined in depth at a later stage of the work.

III.

ARTICLE BY ARTICLE COMMENTARY ON THE PRELIMINARY DRAFT UNIFORM RULES

Article I

20. As has already been indicated above in the general considerations, one of the primary concerns of the Study Group was to permit the free growth of factoring as a technique for financing international trade.

While noting the absence of definitions of factoring in national law and at the same time recognising that any definition adopted by it would be effective only within the context of the uniform rules, the Group sought to establish as wide as possible a definition so as not to hinder the expansion of activities which already are, or may be, regarded as factoring in certain countries, by implying that they do not in fact constitute factoring operations for the purposes of the future rules. The definition in paragraph 1 attempts therefore to extract what may be regarded as the lowest common denominator in factoring contracts, namely provision for an assignment by the supplier to the factor on a continuing basis, by way of sale or security, of receivables arising from the sale of goods, and an obligation on the part of the factor to provide two or more of the services mentioned in Article 1, paragraph 2.

21. As regards the nature of the assignment by the supplier, it should be noted that three conditions must be satisfied under Article 1, paragraph 1. First, the assignment must be "on a continuing basis", an expression preferred to the words "on a regular basis" which, it was suggested, might give the impression of conferring on the factor an exclusive right in respect of all the supplier's receivables, for while it is true that the selection of receivables is to be made by the factor and not the supplier and that usually the supplier will offer to the factor all his receivables or at least all of certain categories of receivables which exist or may come into existence, it was felt that a supplier ought not to be obliged to assign all his receivables to a single factor. Secondly, the assignment must be by way of sale or security, that is to say that there must be either an outright sale or a loan of money on the security of the receivables, a requirement which has the effect of excluding the mere collection of debts by a collection agency. Lastly, the receivables assigned must arise from the sale of goods which, according to paragraph 3 of Article 1, includes except as otherwise indicated the supply of services. This specification of the nature of the receivables derives from the fact that in the view of some of the members of the Group the term "receivables" in the English text might be broad enough in certain countries to include, for example, leases. The Group as a whole however preferred not to employ the term "accounts receivable" which, although perhaps more accurately reflecting the intention of the drafters, is employed in certain jurisdictions only.

22. Turning to the obligations of the factor under the factoring contract, the Group recognised that the recent growth in factoring in volume, sophistication and geographical extent, has led to the provision by the factoring profession of widely differing services. Not all of these

are mentioned in paragraph 2 of Article 1 but only the four which are most commonly provided in factoring operations, namely financing, the maintenance of accounts, the collection of receivables and protection against credit risks. Opinions differed within the Group as to whether the provision of any of those services was absolutely indispensable as an element of factoring but practical examples were cited to show that each of them might be absent from a factoring contract. It is for this reason that none of them is specifically mentioned in paragraph 1 in the general definition of factoring contracts although that provision does require that at least two of them must be present if the agreement between the supplier and the factor is to be regarded as such a contract for the purposes of the uniform rules. In this connection it may be noted that attention was drawn to the fact that the effect of requiring the provision of at least two of the services mentioned in paragraph 2 might be to exclude from the scope of application of the future rules certain operations of bulk factoring, under which the factor is required to give notice to the debtor of the assignment of receivables to him by the supplier but is responsible only for financing and does not guarantee credit protection to the supplier, maintaining as he does a right of recourse against the supplier.

23. On the more general question of whether the uniform rules should be limited in their application to recourse factoring the Group decided against such a restriction, partly so as not to limit the scope of application of the rules, granted the possibility of the evolution of new forms of factoring, but also because difficulties might arise if a supplier were to exceed the limit of the factor's credit approval. In such circumstances the factor would be entitled to bring a recourse action against the supplier in connection with the amount exceeding the credit limit, but not in respect of the amount within that limit with the consequence that one part of the receivables assigned would be subject to the uniform rules and the other not.

24. Finally, in connection with Article 1, the Group gave serious consideration to the possibility of limiting the application of the rules to the usual case where the receivables to be factored arise under a contract of sale which makes provision for payment to be made by the purchaser within at the most twelve months from the delivery of the goods or completion of the supply of the services. The view was in particular expressed in this connection that if such a twelve month time-limit were to be exceeded then the financial operation involved would be that of forfeiting rather than factoring, although against this it was argued that there has in recent years been a development, especially in Scandinavia, of factoring operations where much lengthier periods are contemplated. Ultimately the Group decided in favour of allowing maximum flexibility by stipulating no time-limit whatever for the payment under the sales contract or contract for the supply of services to which the receivables relate.

Article 2

25. If Article 1 of the draft uniform rules provides a broad definition of factoring contracts, Article 2 establishes some important restrictions on the scope of application. Paragraph 1 expressly limits the application of the rules to international factoring contracts, which are defined as 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". That is to say that the international element derives not from the factoring contract itself, which will normally be concluded by a supplier and a factor in the same country, but rather from the underlying contract for the sale of goods or the supply of services. This is quite logical for it is one of the principal aims of the uniform rules to facilitate factoring as a technique for financing international trade. The definition of the international character of the sale of goods is taken over from Article 1 paragraph 1 of the United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980 while the rule designed to clarify what is precisely the place of business for the purposes of the transaction in question of parties who have more than one place of business, namely that having the closest relationship to the contract of sale and its performance, is based on the provisions of Article 10(a) of the same Convention.

26. While the reasons for the Group's decision to restrict the scope of application to international factoring have already been set out above in the general considerations (see paragraph 14), some explanation of the words "wholly or in part " is called for. These were inserted at the suggestion of one member of the Group who pointed out that a supplier might under the same factoring contract assign to a factor receivables arising under both domestic and international transactions so that it would be necessary to distinguish the assignment of the latter receivables, to which the future rules would apply, from the former, to which they would not unless their application had been extended by national law to assignments of receivables arising under purely domestic contracts.

27. The purpose of paragraph 2(a) is to exclude from the application of the rules the factoring of receivables arising from sales to consumers although it is arguable that such operations are probably quite rare in the international sphere. As to the use of the term "customers" in sub-paragraph (a) to indicate the debtor under the underlying contract of sale, this choice was made so as to avoid creating confusion in the minds of United States lawyers to whom the term "debtor" would normally signify the supplier as debtor under his contract with the factor, the customer of the supplier being more often referred to as the "accounts debtor".

28. The effect of sub-paragraph (b) of Article 2, paragraph 2 is to exclude from the scope of application of the rules non-notification factoring, an institution usually preferred by suppliers who do not wish their customers to know that they have recourse to a factor, and which in the opinion of some members of the Group is not factoring at all but rather a form of invoice discounting. Other members were however unwilling to exclude non-notification factoring from the definition of factoring contracts in Article 1 by incorporating the requirement of notice into that provision although they were prepared to concede that the rules applicable to notification and non-notification factoring might differ substantially, especially in connection with the rights of persons not parties to the factoring contract itself and they consequently agreed to resolve the matter in the manner indicated in paragraph 2(b) of Article 2.

29. In connection with this provision, it should finally be noted that it does not specify the time at which notice is to be given to debtors of the assignment of the receivables. Originally the Group had contemplated the possibility of providing that notice must be given at or about the time of the sale, as such notice is normally indicated on the invoice. It was however pointed out that the usual practice in some countries such as the United Kingdom is for a newly concluded factoring agreement to make provision for the assignment to the factor of existing receivables due to the supplier, notice in respect of which assignment is given by letter to the debtor perhaps some considerable time after the conclusion of the sales contract. As the text now stands however such situations would seem to be covered although fears were expressed in some quarters that the provision is too broadly drafted in as much as it might be interpreted as covering all forms of accounts receivable financing such as confidential factoring and invoice discounting arrangements which allow for notice to be given only in certain circumstances.

Article 3

30. In view of the decisions of the group already referred to in the general considerations to deal in the uniform rules neither with the validity of the factoring contract nor with the question of priority disputes with respect to the receivables between the factor and third parties, the content of Article 3 is limited to the validity and enforceability of assignments of existing or future receivables as between the supplier and the factor. The article was the subject of lengthy discussion within the Group and finds its place among those provisions of the draft designed to remove obstacles to international factoring operations.

31. The purpose of sub-paragraph (a) is essentially to overcome the difficulties in certain jurisdictions concerning the assignability of future receivables in that an agreement to assign such receivables, let alone a purported assignment of them may be unenforceable because of the lack of identification of the receivables. In effect the provision states that a contractual provision for the assignment of receivables, be they present or future, is valid even though they are not specified individually, thus acknowledging the validity of global assignments, subject to the proviso that at the time when they come into existence they can be identified as falling within the contract. Whether this last requirement has been satisfied will in the event of a dispute be a question to be determined in each individual case by the judge, and while the Group was unwilling to lay down any criterion itself it noted a suggestion by one of its members that considerations which might be relevant in deciding whether the future receivables are identifiable for the purposes of Article 3(a) are determination in the factoring agreement of the lines of goods or services whose sales are included in the contract, of the countries of the customers and, where possible, of a list of usual customers the supplier and the factor have agreed upon. What is however clear is that under no circumstances does the provision permit the assignment of receivables which are uncertain.

32. It should be noted with regard to sub-paragraph (b) that it constitutes a considerable advance over certain national laws in the direction of stimulating factoring by establishing the rule 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 transfer by the supplier after the receivables have come into existence. While this provision reflects the existing position in a number of States, although it was recalled by one member of the Group that in his country it is not uncommon for a separate assignment to be made purely for evidentiary purposes so as to avoid the need for the factoring contract and all its terms to be exhibited in court, in others a separate act of assignment distinct from the factoring contract itself is necessary for the receivables actually to be transferred to the factor. It was, therefore, on the understanding that the rule established in sub-paragraph (b) will not, in accordance with the general scope of application of the future rules, affect the rules of national law relating to assignments of receivables arising out of domestic transactions that agreement was reached to include it in the text of the draft.

33. Finally in connection with Article 3, it should be borne in mind that it is not concerned with the formal requirements for an assignment in the sense of what is necessary to make a valid assignment under national law. These questions will continue to be regulated by the law applicable to the assignment between the supplier and the export factor, or between the export and the import factor in the event of a second assignment.

Article 4

34. In the opinion of a number of members of the Group and of representatives of the factoring profession, this article is the most important and certainly the most innovatory of the whole draft. Although some oppostion was expressed to it in that it interferes with the exercise of the autonomy of the parties to the underlying contract of sale, and one member of the Group considered that if it were included in the draft it would be necessary to add the word "Contracting" before "States" in Article 2 to protect debtors in non-Contracting States, a large majority favored the inclusion of a rule to the effect that the assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement prohibiting such assignment between the supplier and the debtor. The proponents of the rule, based on a provision to be found in the United States Uniform Commercial Code, insisted on the advantages which it would have for the granting of credit to suppliers. They drew attention to the fact that at present some large companies often take advantage of their position of strength to impose their standard contracts, which contain such a prohibition, on small suppliers who because of their limited financial capacity are precisely those who have most need of the services offered by factoring companies. It was also argued in favour of the provision that it would encourage suppliers to inform their customers that they have recourse to a factor and that prohibitions on assignments to factors are inoperative, while it was at the same time recalled that the draft in no way prevents recovery against the supplier by the customer for any damage he might suffer as a consequence of the breach of the prohibition contained in their contract, whether it be an individual contract or a term of a master contract regulating future transactions between them.

Article 5

35. In the course of its discussions the Committee noted that although in some legal systems the assignment to the factor may carry with it the supplier's rights under the contract of sale, including any provision in the contract reserving title on the goods to the supplier, in others there might be certain limitations and it was agreed that the parties to the factoring contract should, either in that contract or in an assignment made pursuant to it, be able to provide for the transfer to the factor, whether automatic or otherwise, of all or any of the supplier's rights under the contract of sale. The wording of Article 5 is however permissive in that it does not make provision for the automatic transfer of such rights merely because there has been an assignment of the receivables, as it might well not be in the interest of the factor to run the risk of incurring liability through his acquiring title to, for example, dangerous goods, as a result of the transference to him of a reservation of title clause (see below, paragraphs 48 and 49).

36. Finally in connection with Article 5, it goes without saying the it in no way seeks to confer validity upon any provision for the reservation of title in the contract between the supplier and his customer nor to regulate questions associated with the recognition or enforceability of such clauses.

Article 6

37. Whereas Article 3 is concerned with the enforceability of the assignment between the supplier and the factor, Article 6 lays down the requirements to be met for the assignment to be effective against the debtor. Given the decision of the Group to exclude non-notification factoring from the scope of application of the future rules, the giving of notice to the debtor becomes of paramount importance and paragraph 1 of Article 6 indicates the characteristics which the notice must have if it is indeed to be effective against the debtor in the sense that it is the factor rather than the supplier to whom he must now make payment.

38. The first requirement is that the notice must be in writing. Although some members of the Group were reluctant to insist on this formality being observed since in a number of legal systems oral notice may be sufficient, a majority felt that it would be preferable in the interests of certainty, and so as to avoid the possibility of lengthy evidentiary disputes, to require written notice. It was also for these reasons that the Group ultimately rejected a proposal which had originally found favour with it to give effect to any assignment which complies with the law of the debtor's place of business. It was moreover recalled that in practice the requirement of writing is almost always observed as notice of the assignment is usually indicated on the sales invoice or, in the event of a factor taking over receivables which are already in existence at the beginning of the factoring contract, by letter addressed to the customers of the supplier. It was also suggested that while oral notice is not sufficient under the rules to place an obligation on the debtor to pay the factor, it might nevertheless have the effect of putting the debtor on notice of the possible existence of a right of the factor to the receivables and thus prevent the debtor paying the supplier.

39. The further conditions in sub-paragraph (a) that the assignment must reasonably identify the receivables which have been assigned and the person to whom the debtor is required to make payment would seem to be nothing more than rules dictated by commen sense for otherwise the debtor would not know the nature and extent of his obligations vis-a-vis the factor.

40. Sub-paragraph (b) of Article 6 paragraph 1 contains a rule originally introduced within the framework of Article 4 and which was designed to reflect the application of a principle of fairness in relation to debtors who have included a prohibition on the assignment of receivables in their contracts with the supplier. On the model of the International Chamber of Commerce Uniform Rules and Practices on Documentary Credits the requirement that the notice must indicate that the assignment is governed by the uniform rules was however subsequently extended by the Group to cover all assignments falling within the uniform rules. The reasons for this extension were essentially twofold. On the one hand it would familiarise debtors, who would normally expect notice requirements to be governed by their own national law, with the special rules applicable to international factoring while on the other it would meet, or at least go a long way towards meeting, a requirement in France that the notice must, to be effective against the debtor, indicate that payment of the receivables is to be made to a factor. It should however be mentioned in this connection that one representative of the factoring profession indicated that this latter requirement was a pecularity of factoring in France and Luxembourg and that purely for marketing reasons some factors preferred there to be no specific reference to factoring in the notice of the assignment of the receivables.

41. The effect of paragraph 2 of the article is to provide that notice of the assignment given before the conclusion of the sales contract is not effective, thus covering the situation where notice is given by the supplier or the factor of a general assignment under a factoring contract and no subsequent notice is given to the debtor; in other words while the assignment of a future receivable may be effective between the supplier and the debtor under Article 3, notice of the assignment of a receivable which will arise under a future contract of sale will not, under the terms of Article 6, paragraph 2, be effective against the debtor.

Article 7

42. This provision may be seen on the one hand as offering a certain measure of protection to debtors and on the other, and as a consequence of that protection, as a further stimulant to international factoring in that the debtor will be more likely speedily to pay the factor if he knows that his liability for the debt is discharged thereby. Such discharge is of course subject to a number of conditions. The first of these, which might perhaps as easily have been dealt with in Article 6, is that the notice to the debtor of the assignment of the receivables to the factor must be given by the supplier or by the factor with the supplier's actual or apparent authority. In cases where the notice is given by the supplier or by both the supplier and the factor there would as a general rule seem to be no difficulties but where the notice is given by the factor alone then the debtor may wish to make enquiries of the supplier to ensure that there has indeed been an assignment.

43. The main purpose of the provision is however to protect a debtor who has paid the factor in cases where the receivable has not been validly assigned by the supplier to the factor or where the right to payment of the receivables was vested in a third party. Evidently, however, the debtor may not simply make payment to any person who claims a right to the receivables on the basis of a purported assignment to him by the supplier. The debtor must act in good faith in the sense that he honestly believes that he must pay the factor and he must in addition be aware of no facts which should have led him to make further enquiries as to the rights of the factor or any other person claiming an interest in the receivables. There was some disagreement within the Group as to quite how far the debtor should be allowed to go in challenging the factor's right to payment. In the opinion of some, he should be entitled simply to call for evidence of the assignment, which would not of course result in the factor having in every case to produce the assignment or the factoring contract, and also to postpone payment in the event of a dispute regarding the validity of the assignment between the supplier and the factor. He would not, however, be expected, nor in the opinion of some should he be permitted, to challenge on his own initiative the validity of an assignment under the law of a country other than his own, since this might be nothing more than a device to delay payment. Other members of the Group, on the other hand, did not see how the debtor could be prevented from challenging the validity of an assignment and they were, in particular, reluctant to include in the uniform rules any provision establishing a positive duty on the debtor to make payment or failing this to raise objections to his having to do so within a stipulated period, which duty, it had been suggested, was a corollary of the protection afforded to him under Article 7. They argued that in the event of refusal by the debtor to pay, the matter could in the last resort only be settled by the courts. At the same time they laid stress on the limited nature of the protection afforded to the debtor for if, notwithstanding notice of someone else's right to the receivables, he went ahead and paid another person on the basis of an erroneous interpretation of his obligations and of other persons' rights, he could find himself obliged to make payment a second time.

Article 8

44. Paragraph 1 of Article 8 embodies the rule common to virtually all legal systems that an assignment cannot place the debtor in a worse position vis-a-vis the assignee than he would have been in relation to the assignor. It provides therefore that the debtor may, if a claim is brought against him by a factor for payment of a receivable arising under a contract of sale, set up all defences against the factor of which the debtor could have availed himself under the contract if such claim had been made by

the supplier. The only exception to this rule, if exception is the correct word, concerns the situation where the debtor has purported to prohibit the assignment of the receivable and since Article 4 provides that such an assignment will be effective notwithstanding the prohibition, the latter cannot be raised as a defence by the debtor against the factor.

45. Paragraph 2 of Article 8 deals with the related but distinct question of the debtor's exercise against the factor of rights of set-off he may have against the supplier. Such rights may be exercised against the factor subject to certain conditions, the first of which is that they are not merely contingent. In other words they must exist and be available to the debtor at the time he receives notice of the assignment for otherwise it would be possible for the supplier and the debtor subsequently to erode the position of the factor by the conclusion of new contracts giving rise to a set-off of which the factor was unaware. In addition, the set-off pleaded by the debtor against the factor must have arisen in respect of claims against the supplier in whose favour the receivable arose for otherwise it might be possible for a debtor to assert a right of set-off in respect of claims against a different supplier regarding receivables which had been assigned to the same factor.

Article 9

46. Whereas Article 8 is concerned with the situation where it is the factor who brings an action against the debtor, Article 9 deals with the converse case where it is the debtor who is seeking to recover from the factor. The scope of the article is limited to non-performance or defective or late performance of the contract of sale and it is provided that in such cases the factor, who after all does not guarantee the performance of the contract by the supplier, shall not be obliged to return money paid to him by the debtor who must therefore content himself with a recourse action against the supplier unless he is in a position to exercise his rights under Article 8. The article does not purport to deal with the situation where the debtor overpays the factor and such cases will fall to be determined by the rules of the applicable law governing restitution and unjust enrichment.

47. There remains one case of the application of Article 9 which was not specifically contemplated by the Group, namely that where title passes to the factor as a result of the assignment to him of a retention of ownership clause. It might perhaps be in order at a later stage of the work to consider whether in such a situation the general rule laid down in Article 9 should operate so as to prevent the debtor recovering from the factor in the event of non-performance or defective or late performance of the contract of sale although support for the application of Article 9 might seem to be forthcoming on the analogy of the rules regarding the factor's extracontractual liability under Article 10.

Article 10

48. Modelled to a certain extent on a corresponding provision to be found in UNIDROIT's preliminary draft uniform rules on the sui generis form of leasing transaction, Article 10, paragraph 1 provides that the factor shall not, by reason only of transfer of title to goods to him as provided by Article 5, incur liability to a third party for loss, injury or damage caused by the goods. This drafting, it should be noted, does not settle the question of whether the same rule would apply if, under the applicable law, the benefit of a reservation of title clause would pass to the factor under the assignment independently of a contractual provision to that effect. It was moreover pointed out by several members of the Group that there might be a conflict between the provision of paragraph 1 on the one hand and those of the draft European Directive on Products Liability on the other and this too is a matter which may be considered in greater depth in the future.

49. Paragraph 2 contemplates two different situations. The first of these corresponds basically to that dealt with in paragraph 1, namely that the factor has acquired temporary ownership of the goods as a result of the application of Article 5 and sells or resells the goods to another factor, the supplier or the debtor. In this case the provisions of paragraph 1 apply. The second situation is where the factor disposes of the goods to a person extraneous to the factoring operations, as where he resells goods he has acquired from a bankrupt debtor, and here his liability for loss, injury, or damage caused by such goods will be determined in accordance with the applicable law.

Article 11

50. The final article of the draft uniform rules recognises the fact that in international factoring the original assignment by the supplier to the factor may be followed by one or more assignments between export and import factors and provides that any such assignments must comply with the rules, the positions of the assignor and assignee factors being equated mutatis mutandis to those of the supplier and the original factor. Likewise, the places of business of the factors involved in subsequent assignments are no more relevant than those of the parties to the original assignment in determining the international character of the factoring operations for the purpose of the uniform rules, which is established by Article 2, paragraph 1.

51. Finally, it should be noted in this context that while Article 11 deals with the case of an assignment by an export factor to an import factor, it does not purport to cover the situation where the notice of the first assignment is given to the debtor by the import

factor as second assignee and not simply as an agent of the export factor responsible for the collection of the receivable. The effectiveness of notice given by the second assignee in such cases would presumably fall to be determined by Article 6, and in the absence of any requirement in that provision as to who should give notice, such notice would appear to be effective against the debtor. The question would still seem to be open however as to whether in each individual case such notice would meet the requirement laid down by Article 7 that notice be given "by the supplier or by the factor with the supplier's actual or apparent authority".

ANNEXE
ANNEX

COMITE D'ETUDE
STUDY GROUP

Le Comité a tenu trois sessions à Rome

1. Les 5 et 6 février 1979
2. Du 27 au 29 avril 1981
3. Du 19 au 21 avril 1982

The Group held three sessions in Rome

1. On 5 and 6 February 1979
2. From 27 to 29 April 1981
3. From 19 to 21 April 1982

LISTE DES PARTICIPANTS
LIST OF PARTICIPANTS

MEMBRES
MEMBERS

- Mr Jean Georges SAUVEPLANNE - Professor of Law, University of Utrecht, Member of the Governing Council of UNIDROIT
  Président du Comité
  Chairman of the Committee (2), (3)

- Ms Bianca CASSANDRO - Assistant Professor of Commercial Law, University of Milan (2), (3)

- Mr Fritz ENDERLEIN - Director, Institute for Foreign and Comparative Law, Academy for Political and Legal Science of the German Democratic Republic, Member of the Governing Council of UNIDROIT (2), (3).

Mr Christian GAVALDA	- Professeur de droit commercial et bancaire, Université de Paris I, Panthéon - Sorbonne (2), (3).
Mr Royston M. GOODE (°)	- Crowther Professor of Credit and Commercial Law, Queen Mary College, University of London (1), (2), (3).
Mr Berardino LIBONATI	- Professeur ordinaire de droit commercial, Université de Florence (1), (2), (3).
Mr Claude LUCAS de LEYSSAC	- Professeur de Droit, Avocat à la Cour de Paris (1).
Ms Tinuade OYEKUNLE	- Assistant Director, International and Comparative Law Division, Federal Ministry of Justice of Nigeria (1).
Mr Albert F. REISMAN	- Representative, Department of State, United States of America (2), (3).
Mr Heinrich Johannes SOMMER	- Managing Director, Diskont und Kredit AG; Member of Factors Chain International (1), (2), (3).

OBSERVATEURS / OBSERVERS

Mr Sergio BIANCONI	- Chef du Service Juridique, Associazione Bancaria Italiana (3).

(°) Président du Comité lors de sa première session/Chairman of the Committee at its first session.

Ms Caroline BILLIOUD de NUZILLET	- Attaché, Secrétariat juridique Chambre de Commerce Internationale (1).
Mr Leo BINDER-DEGENSCHILD	- Managing Director of Factor-Bank; Deputy President and representative of International Factors Group (3).
Mr Renato CLARIZIA	- Professor of Civil Law, Università degli Studi di Urbino (3).
Mr Paolo CLAROTTI	- Chef de la Division "Banques" Commission des Communautés Européennes (1), (2).
Mr Philippe CONTE	- Président Directeur Général, France - Factor et Centrale - Factor (3).
Mr Georges DROZ	- Secrétaire Général, Conférence de La Haye de droit international privé (2), (3).
Mr Vincenzo FLORIDI	- Representative, "Associazione Nazionale Imprese Assicuratrici - ANIA" (2).
Mr Aldo FRIGNANI	- Professor of Comparative Private Law, University of Modena; Representative of A.TE.FI., "Associazione Tecnica delle Società Finanziarie" (3).
Mr Lars KINANDER	- Assistant Vice President, Svenska Finans/Svenska Handelsbanken (1).
Mr Jeroen KOHNSTAMM	- Secretary-General, Factors Chain International (3).

Mr Antonio ROSSI	- Legale dell'Istituto Bancario San Paolo di Torino; Consulente legale della Eurofactoring, S.p.A. (3).
Mr Frederick R. SALINGER	- Chairman - Legislation Committee, Association of British Factors (2), (3).
Mr Frans VANGEENBERGHE	- Administrateur Principal, Conseil de l'Europe (3).

SECRETARIAT

Mr Mario MATTEUCCI	- Président / President (1), (2), (3).
Mr Riccardo MONACO	- Secrétaire Général / Secretary-General (1),(2).
Mr Malcolm EVANS	- Secrétaire Général Adjoint / Deputy Secretary-General (1), (2), (3).
Mr Joachim BONELL	- Collaborateur / Collaborator (1), (2).
Mr Martin STANFORD	- Chargé de Recherches / Research Officer (2).
Ms Marie-Christina RAULT(°)	- Chargé de Recherches / Research Officer (1).
Mr François MENGIN	- Chargé de Recherches / Research Officer; Secrétaire du Comité / Secretary to the Group (2), (3).
Ms Loretta MALINTOPPI	- Assistant scientifique associé / Associate legal assistant (2).

(°) Secrétaire du Comité à sa première session / Secretary to the Committee at its first session.